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Vetiva Research

A break in the clouds

2021 Macroeconomic Outlook

December 2020

Executive Summary

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Economic Research

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What a year 2020 has been! From optimistic expectations of broad-based global growth to conversations around the Sino-US trade tensions and its ability to stall the anticipated positive growth outcome, to the outbreak of a global pandemic that started out as a local outbreak in Wuhan, to civil unrest across many countries as socio-economic pressures mounted, to the debates over the US' turbulent post-election process, 2020 has indeed morphed into the unthinkable – a year filled with so much turbulence.

However, we can all agree that 2020 has been a year of reforms and remarkable developments, not just for governments around the world, but also for businesses and individuals. As we gradually draw the curtains on this remarkable year, we should remind ourselves that surviving this year is as much an achievement, as collecting trophies. We just lived through the most severe economic downturn in recent history, and that is an achievement worthy of pomp.

Looking ahead however, we see a break in the clouds. Research breakthroughs on a medical solution to the virus, hold promise of a growth comeback in 2021. With the base expectation of a vaccine rollout in H1'21, the hope is that normalcy can return to many countries. In addition, a more cordial and diplomatic relationship between the US and the rest of the world - especially with respect to trade - could tilt global macroeconomic risks to the upside, putting many countries back on the growth path.

But the road to recovery could be quite arduous. Things could get worse before they get better. Many countries came into the pandemic with pre-existing weaknesses. Large fiscal and current account deficits (Brazil; South Africa), mono-sector economic structures (Columbia; Russia) and inconsistent macroeconomic policies (Turkey; Mexico) are weaknesses that can magnify vulnerabilities in the near term and weigh on recovery efforts by global policy makers. As such, global economic recovery from the pandemic-induced downturn, remains fragile and patchy.

Many countries have seen a deterioration in real sector indices (Nigeria; Venezuela), fiscal slippage (South Africa; India), and external sector volatilities amid the persistence of the virus. Many are also simultaneously experiencing unprecedented capital reversals, substantial currency depreciations and sharp downgrades to their sovereign debt ratings and/or outlooks – with countries like South Africa, Maldives, and Angola recording double-downgrades in the year. The most vulnerable countries have also been forced to turn to the International Monetary Fund (IMF) for emergency funding or debt relief.

In addition, the risk of a second wave of the virus is real now more than ever. While public health systems are already stretched globally, the advent of winter could see a material increase in new cases - especially in boreal regions. The global easing of travel and tourism restrictions also raises the risk of cross-border infections, as seen in the first wave, while the return of social interaction could accelerate local transmission. Let us not also rule out the case of a delayed rollout of and/or unequitable access to the vaccines.

As much as we are optimistic about a global economic recovery in 2021, there are still potential risk factors. There always are. But we are betting on a more predictable and somewhat less exciting (compared to 2020) 2021. Recovery in 2021 may however be K-shaped – uneven and split between industries and income groups. Technology related sectors could record stellar growth, while structural impediments – especially in emerging markets – could constrain manufacturing recovery. The process of re-thinking supply chains could weigh on both domestic and international trade, and delayed recovery in middle-class incomes could cause growth in realty to lag.

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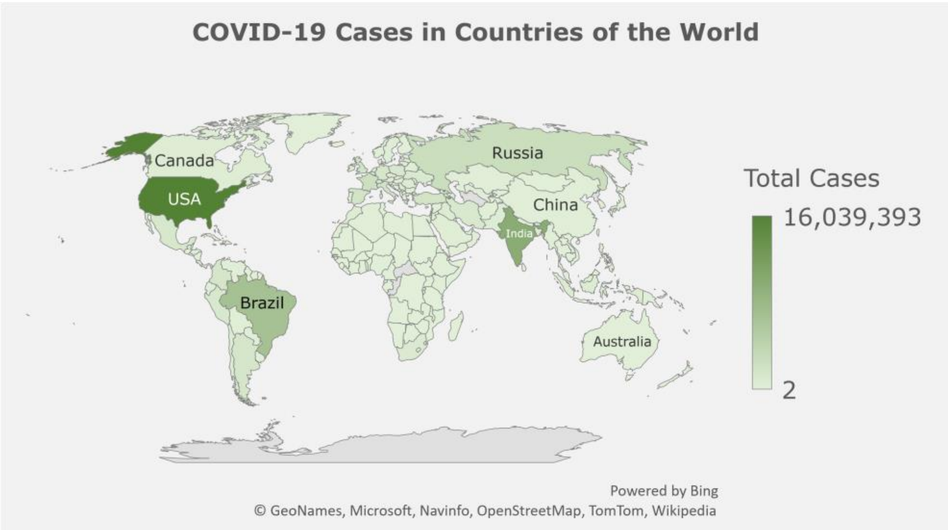
Global Economy

Clouds of uncertainty

The year 2020 began on an optimistic note as the world braced up for reduced United States (US)-China tensions and clarity on Britain's exit from the European Union (EU). However, the outbreak of the COVID-19 pandemic upturned any form of optimism for the year. Fears of contagion led to the imposition of social distancing measures, travel restrictions and lockdowns. As a result, the lives and livelihoods of many - especially in the services and informal sector - were threatened as jobless claims rose in advanced economies and socio-economic progress reversed in emerging and developing economies. Global trade was equally affected as supply chains were disrupted by export restrictions and travel bans. Service-based sectors including tourism and travel suffered from the fundamental shift in consumer behaviour as a result of the pandemic.

As a gradual re-opening surfaced in Q2'20, the pace of infections slowed down amid adoption of social distancing measures and remote working activities that reduced physical interaction and shifted the business landscape to a virtual environment. While the reopening provided a temporary relief for these economies, increased local transmission resulted in higher cases calling for a second wave of lockdown measures in several European countries and some part of the US.



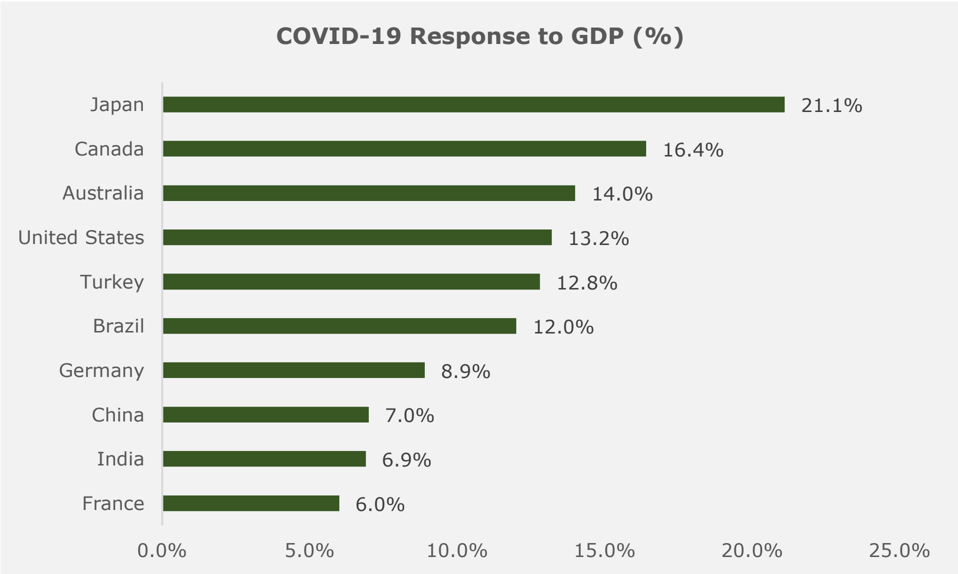
Source: Worldometer, Vetiva Research

Policy responses to the coronavirus pandemic

Coordinated responses - involving fiscal and monetary stimuli - have been implemented to cushion economic impact of the pandemic. Governments with deeper pockets were able to implement sizeable stimulus measures, to shield their economies from the harsh impact of COVID-19. The governments of the world have spent close to $12 trillion in fiscal responses to the pandemic. These responses have taken several forms including emergency spending, tax deferrals, sovereign guarantees, reprioritization of budgets, support for vulnerable groups, payroll supports amidst others.

In terms of GDP, Japan's fiscal stimulus package leads (21.1%), followed by Canada (16.4%), Australia (14%) and the United States (13.2%). In the United States, we saw the largest stimulus package in absolute terms ($2.3tn), under the Coronavirus Aid, Relief and Economy Security (CARES) Act. The Act made provision for tax rebates, unemployment benefits, loanable funds and aid for companies and sub-national governments. In Asia, Japan approved two stimulus packages totaling $2.18 trillion, inclusive of corporate funding, medical and rent supports as well as pay-outs to low-income earners and artisans.

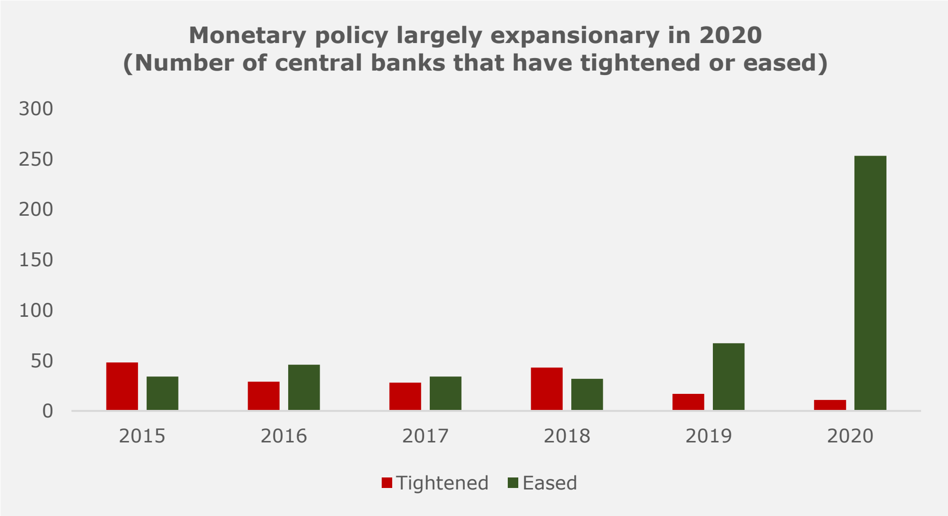
In Europe, the EU adopted an $860 billion (€750 billion) stimulus package to support members of the bloc, which had been hit most by the pandemic in form of grants and loans. Constituting 4% of the EU GDP (ex-UK), the European Commission set aside a lump sum of €540 billion ($635 billion) for member countries to provide health-related spending, government guarantees, corporate support and job protection. In the UK, £48.5 billion ($64.50 billion) was provided to support the National Health Service (NHS), public services and charities. To tackle the socio-economic effects, the UK government also launched business interruption loan schemes to support SMEs and corporations, while providing wage support for self-employed and furloughed workers.



Source: Statista

To consolidate fiscal efforts, central banks utilized both monetary and macro-prudential measures to alleviate the impact of the pandemic. This was carried out through rate cuts, relaxation of reserve requirements, credit supports, restructuring of loans, extension of moratoriums and asset purchase programs. As noted by the IMF, 60% of central banks reduced their benchmark rates below 1% while one-fifth have their interest rates below 0%. This is indicative of the magnitude of monetary stimulus that has been rolled out to respond to the pandemic.

The slowdown in inflation has also supported broad-based easing. With respect to individual responses, the US Fed kept its benchmark rate near zero while the Bank of England and Australia reduced interest rates to an all-time low of 0.1%. In 2020, more rate cuts have been delivered than in the past 5 years. Only 11 rate hikes have been recorded thus far, compared to a 5-year average of 33 hikes, lending credence to the massive monetary support that Central Banks mustered to respond to the pandemic.



Source: Central Bank News, Vetiva Research

In line with the expansionary monetary stance, central banks resumed quantitative easing (QE) to improve liquidity in the financial markets. Quantitative easing activities enable central banks to effectively reduce interest rates by injecting liquidity into the market, thereby enabling banks to provide cheaper loans to businesses. Fitch estimates that global asset purchases could reach $6 trillion in 2020, which translates to more than half of the cumulative global QE carried out between 2009 and 2018.

Despite initially announcing $700 billion worth of asset purchases, the US Fed committed to additional monthly asset purchases of $80 billion. Thus, the Fed has bought more US Treasuries than it did during the global financial crisis. In June, the European Central Bank (ECB) increased bond purchases by €600billion ($706 billion) in addition to the €750 billion ($882 billion) bond purchases embarked upon in March, resolving to sustain the record bond purchases till June 2021.

Elsewhere in Europe, the Bank of England (BoE) resumed bond purchases, which has been increased to £895 billion ($1.19 trillion) thus far in 2020. The additional bond purchases undertaken by the BoE in 2020 overshadows the additional bond purchases undertaken during the global financial crisis, the Eurozone debt crisis, and the Brexit referendum. In Asia, the Bank of Japan (BoJ) pledged to purchase unlimited quantity of government bonds, while also purchasing exchange traded funds. The BoJ also raised the upper limit of commercial paper and corporate bond holdings to a total of ¥20 trillion ($186 billion).

Due to the massive stimulus packages implemented by several economies in response to the first wave of the pandemic, the IMF revised its growth expectations for 2020 (-4.4% y/y vs. -4.9% y/y earlier) due to the pick-up in consumer spending, positive GDP surprises and recovery in global trade that followed the reopening of economies. As governments and central banks develop initiatives to tackle the pandemic, the recovery of the global economy hangs on the administration of a vaccine and continued policy support measures. Consequently, the IMF expects a 5.2% y/y rebound in global output in 2021.

IMF FY'21 Forecasts	GDP (%)	Inflation (%)
World	**5.2**	**3.4**
Advanced Economies	3.9	1.6
US	3.1	2.8
Euro Area	5.2	0.9
UK	5.9	1.2
Japan	2.3	0.3
EMDEs	6.0	4.7
China	8.2	2.7
India	8.8	3.7
ASEAN-5	6.2	2.3
Saudi Arabia	3.1	3.7
Russia	2.8	3.2
SSA	3.1	7.9

Source: IMF, Vetiva Research

The Fund expects advanced economies to record their sharpest recession in at least a decade, in 2020 before recovering in 2021. Among our selected advanced economies, the UK is expected to experience the largest rebound of 5.9% y/y in 2021 from a steep contraction of 4.9% y/y in 2020. The Euro Area is projected to recover by 5.2% y/y in 2021, after sliding by 8.3% y/y in 2020. The Fund also projected a 4.3% y/y and 5.3% y/y slide in the United States and Japan respectively in 2020, before recovering by 3.1% y/y and 2.3% y/y respectively in 2021. China is expected to grow slightly by 1.9% y/y in 2020, its worst output growth in four decades, before recording a stronger output growth of 8.2% in 2021.

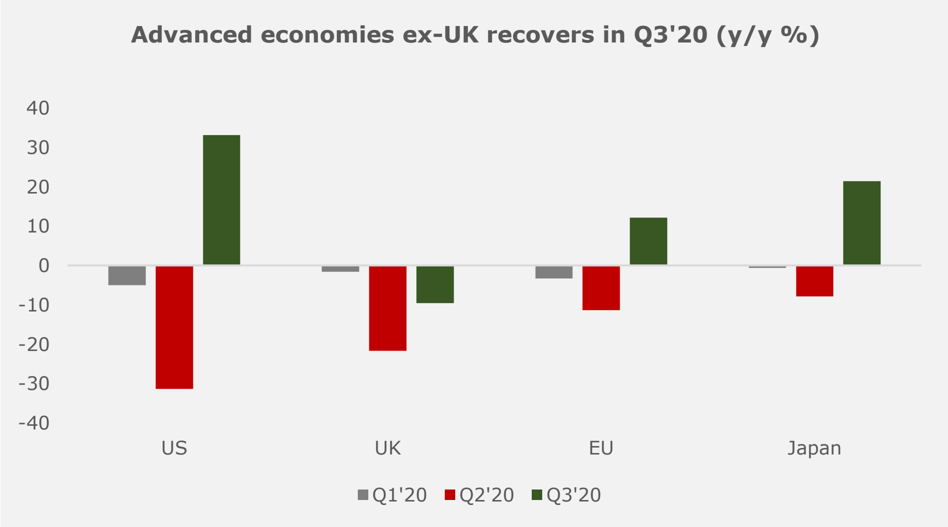
Advanced Economies – Rebound at risk?

The stringent lockdown measures imposed in advanced economies yielded double digit contractions during the first half of the year. The United States slid into a recession following an output slide of -4.8% y/y and -31.4% y/y in Q1'20 and Q2'20 respectively, but eventually rebounded sharply in Q3'20 by 33.1% y/y. The rebound in Q3'20 represents the country's strongest quarterly performance in history, supported by the strong, well-targeted fiscal stimulus that contributed to the revival of domestic consumption.

In like manner, the Eurozone area recorded a 12.1% y/y recovery in Q3'20, after a 3.3% y/y and 11.4% y/y slump in GDP during the first two quarters of the year respectively. Recovery in the Eurozone area in the third quarter was driven by broad-based growth in constituent economies as the area emerged from the first wave of lockdowns. This recovery represented its sharpest expansion in two and a half decades. Double digit expansions were seen in Italy, France and Spain, countries with the highest number of coronavirus cases in the region.

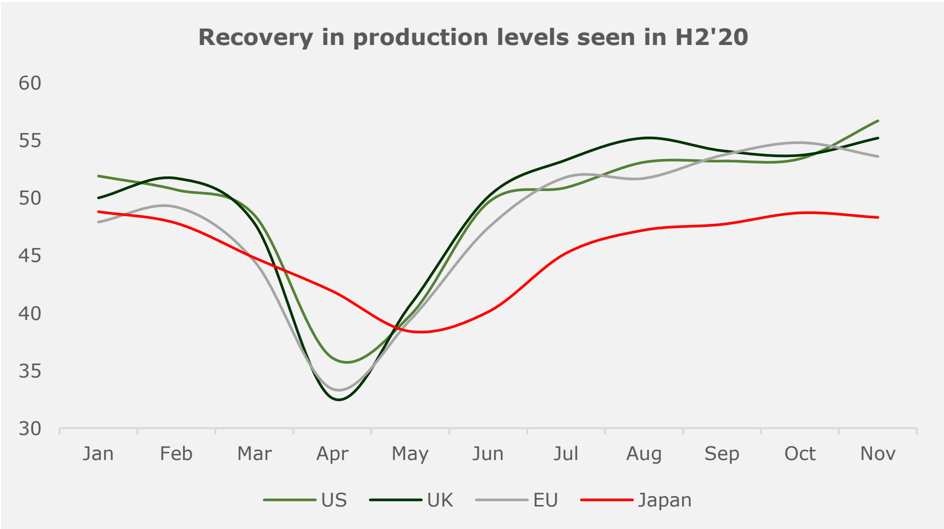
Also in Europe, the United Kingdom (UK) was the worst hit economy with a 20.4% y/y slump in Q2'20, no thanks to the slow response of the government, the length of the lockdown and a higher contribution of the most affected sector (services) to GDP than peers in the region. The slump in the hospitality and travel sectors, as well as Brexit-related slowdown in investment spending, underscored the downturn in the economy.

Down to Asia, the Japanese economy had been contracting before a national emergency was announced to contain the pandemic. While there were no strict lockdowns, spillovers from Sino-US tensions, a spat with South Korea and a poorly timed consumption tax hike weighed on the economy. The resulting slowdown in consumption, occurrence of natural disasters and suspension of Olympic-related expenditure took a toll on economic activity, resulting in a 0.6% y/y and 7.9% y/y downturn in Q1’20 and Q2’20, respectively. This Q2’20 contraction represented the worst post-war economic contraction Japan has ever recorded. However, the economy rebounded by 21.4% in Q3’20 due to its robust stimulus package, as well as the pick-up in consumption and exports.



Source: Bloomberg, Vetiva Research

Despite the slump in output, production levels picked up in the second half of the year as fiscal and monetary stimuli stirred economic activity. A panoramic swoop across the manufacturing PMIs of advanced economies revealed a synchronized slowdown in the first half of 2020. However, production activity picked up in our select countries following the relaxation of lockdowns and reopening of economies.



Source: Bloomberg, Vetiva Research

As the pandemic weighed on output growth, consumer prices were equally affected as food and essential products constitutes a lower fragment of the consumption basket of individuals in advanced economies. Therefore, inflation fell during the first half of the year on the back of weak aggregate demand, while a mild pick-up was recorded between July and August due to the reopening of economies.

Although inflation in other advanced economies was subdued in Q3’20, the US experienced a rise in inflation due to pre-election spending and stimulus packages. Nonetheless, inflation remained below the Federal Reserve Bank’s (Fed) erstwhile target of 2%. In the UK, tax cuts and subsidies kept prices low as inflation fell below 1% while Eurozone inflation fell below zero, as depressed demand induced consistent price reductions amid lay-offs, weak consumer demand, and price discounting. Japan experienced a similar scenario as inflation fell towards zero, indicative of softer energy prices and government’s discounts to drive aggregate demand.

Scientists have battled for months to get a medical solution to the pandemic by providing a vaccine against the virus. However, vaccine development has had its own challenges given reports of unexpected reactions in some participants during the conclusive stages of trials. The arrival of a safe vaccine would be critical in subduing the virus and its butterfly effect on the global economy. With positive news from Pfizer and Moderna, global markets rode on the waves of optimism that the vaccine would serve as a precursor to economic recovery.

However, the vaccine still needs to undergo broader tests across geographies and demographics before it can be rolled out to a population large enough to achieve herd immunity. An emerging second wave of lockdowns in the fourth quarter of 2020 could dampen growth prospects in advanced economies, especially in Europe. This is because reinstating curfews - as seen in Ireland, Czech Republic, Belgium, France, and Germany – could have dire consequences for economic recovery.

In the US, following Joe Biden’s victory at the polls, an increase in political animosity could further delay government response to the pandemic. However, the Fed may step in with more stimulus to maintain confidence in the economy. Biden’s victory signals the return to a more predictable multilateral approach to international relations. This could give businesses in the US the confidence to embark on investment projects that can create new jobs and improve consumption levels. Post-transition to a Biden Presidency, regulatory approval for a medical solution to the pandemic and substantial fiscal stimulus could buoy economic recovery further in the US.

Following the resignation of Japan’s former Prime Minister, Shinzo Abe, in Aug’20 over health concerns, the new prime minister, Suga Yoshihide, could be laden with many responsibilities in the near term. With Japan’s parliamentary elections scheduled for Oct’21, Suga has less than a year to curb the COVID-19 outbreak in his country, to enable Tokyo to host the spectator-less 2021 Summer Olympics and provide the necessary policy support to sustain the economic recovery recorded in Q3’20. So far, he has committed to push for a strong foreign policy – especially relations with the US – and some economic reforms, a course set by former Prime Minister Abe. Although reviving the economy could be a priority on his to-do list, he is faced with other daunting challenges like tackling government debt and the ageing population, which could slow down Japan’s economic growth in the long term.

Emerging Markets and Developing Economies (EMDEs) – Dangers lurk beneath the surface

The pandemic knocked the developing world on both economic and health fronts. On the health front, a rapid rise in infection cases coupled with a struggle in crisis containment emerged in several EMDEs especially those in Latin America and Asia. This is partly attributed to low testing capacity and increased community transmission upon re-emergence from the first wave of lockdowns. This explains the rising cases of the virus recorded in Brazil, Russia, Argentina and other developing economies.

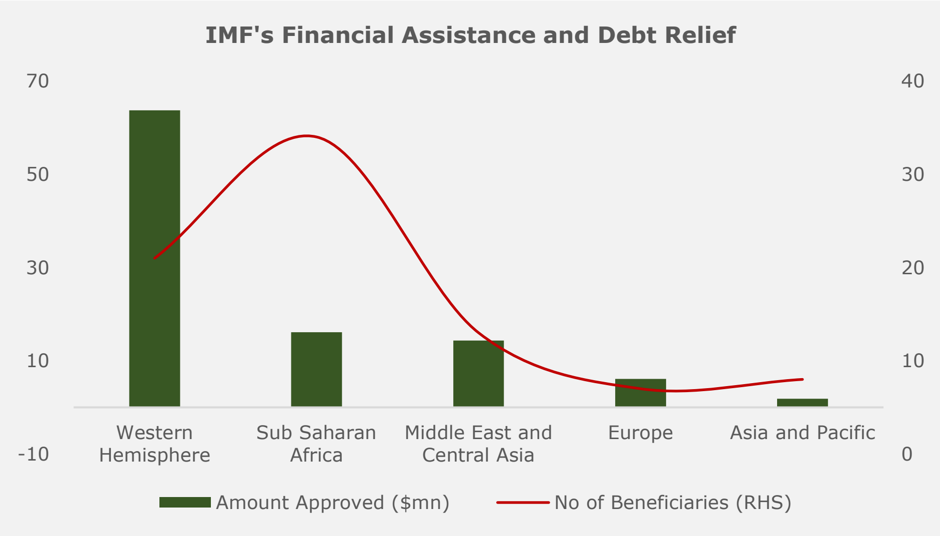
Besides the health implications, emerging economies nurtured bruises from the spill-over effect of the pandemic to their economies, many of which have a larger informal economy and sizeable number of vulnerable persons. Resource-dependent countries were also shaken by the slump in commodity prices, which created fiscal and external imbalances. With the slump in commodity prices came lower export revenues, while the lockdowns pummeled tax revenues threatening budget execution and the ability of governments to reel out sizeable stimulus measures. The lack of social safety nets amplified the impact on vulnerable groups, reversing decades of socio-economic progress and poverty reduction.

Before the pandemic, the spat between the US and China, as well as a shortfall in global demand crippled growth in trade. The emergence of COVID-19 has caused trade volumes to fall to levels last seen during the global financial crisis. The closure of air, land and sea borders, alongside imposition of export restrictions on medical and food items weakened trade volumes. Responsible for c.20% of global manufacturing intermediate products, the slump in Chinese demand dovetailed into other developing economies, from which the country sources raw materials.

Trade in services was equally affected as travel restrictions, closed air borders, and decreased demand for hotel services ensued from the preventive measures taken to curb the spread of the virus. According to the International Air Transport Association, air passenger travels fell by 94% y/y in April 2020, coinciding with the periods of lockdowns in many parts of the world. As a result, international tourism arrivals fell by 44% during the first four months of 2020, as fewer social interactions and contagion fears resulted in travel bans.

With the slump in trade and tourism affecting the current account balance of several EMDEs, the financial account balance of several EMDEs were impacted by sharp capital reversals in the wake of the crisis. The spate of capital outflows outweighed that seen during the global financial crisis, and Fed's policy normalization in 2008 and 2013 respectively. A record $83.3 billion outflow during the month of March signaled the risk-off sentiments ensuing from the spread of COVID-19 as investors sought refuge in safe haven assets such as gold and other precious metals. However, these flows to emerging markets picked up further in the year, given the low interest environment in advanced economies and reopening of economies.

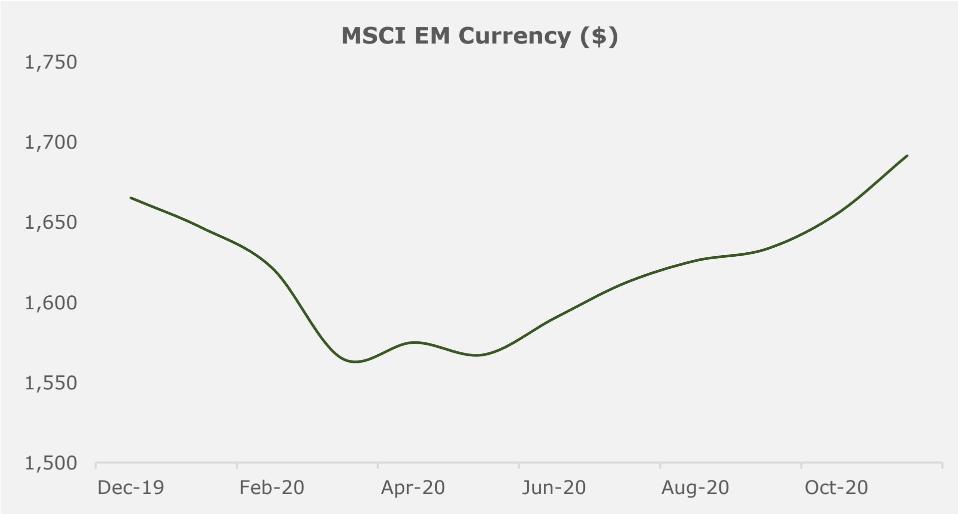
Multilateral flows were pivotal to the external sector of EMDEs as the heightened risk environment, weaker currency and sovereign debt downgrades would have raised the cost of borrowing from commercial lenders. While the developing world struggled from twin shocks on government finances and exports, the IMF alongside the G-20 nations worked towards introducing debt relief for poor countries. This afforded EMDEs the opportunity to channel resources to fighting the pandemic, rather than settling debts. As at the writing of this report, the IMF in its own capacity has provided financial assistance and debt relief worth $102.1billion to 83 countries. Of all regions, the Western Hemisphere received the highest financial assistance ($63.7mn) while Sub-Saharan Africa had the highest number of beneficiaries (34).



Source: IMF, Vetiva Research

Given the nature of the shock, job losses and wage cuts in advanced economies trickled down to developing economies in form of lower remittances. The World Bank estimated global remittances will plunge by 20%. Projected to fall by 27.5% y/y in Europe and Central Asia, 23.1% y/y in Sub Saharan Africa, and 19.6% y/y in Middle East and North Africa, the World Bank recognizes that remittances may not play its role as a cushion in hard times due to the overarching impacts of the pandemic on all regions of the world. Countries like Mexico receive more from remittances than oil exports and as such, remittances helped families to shore up consumption. Thus, the fall in remittances could restrain demand, widen inequalities, and worsen poverty levels.

As the pandemic has weakened the external sector of EMDEs on various fronts, currency volatilities ensued. However, the weakness of the dollar supported recoveries in EM currencies, especially the BRICS currencies. Nevertheless, the Chinese Yuan recovered against the dollar following its positive GDP surprises. In the run up to the US elections, EM currencies gained momentum as portfolio investors took advantage of the gross undervaluation of these currencies. Towards the end of the year, the MSCI EM currency index has shown resilience due to the gradual reopening of economies, run-up to the US elections that propelled the weakening of the dollar, and favourable vaccine announcements.



Source: Bloomberg, Vetiva Research

The developing world could be on the brink of a pandemic-induced debt crisis if another wave of the virus ensues, due to sharp currency depreciations and unsustainable debt accumulation. Given the slump in both commodity prices and foreign portfolio inflows, more EMDEs are faced with the risk of debt distress. Already countries such as Argentina, Lebanon and Zambia have defaulted on debt obligations during the year.

BRICS – China consolidates recovery

The BRICS bloc constitutes one of the fastest growing emerging economies in the world. Consisting of Brazil, Russia, India, China and South Africa, the bloc accounts for over 20% of the global economy. The advent of the pandemic reiterated the need for multilateral development banks, as envisaged by the five countries when establishing the New Development Bank. The bank was able to support the constituent economies with a total of $4billion during the pandemic, asides financing over 50 infrastructure projects across the bloc prior to the health crises.

The history of the pandemic cannot be bypassed without alluding to these economies. From its origination in China, the country initiated stringent containment measures to slow the rate of infection and curb the spike in cases. Coincidentally, members of the bloc have the highest number of COVID-19 cases in their respective continents from Brazil in Latin America, to South Africa in Africa. Russia and India also top the list in Asia. With the highest death toll in Latin America, Brazil is among the economies with high number of deaths among health professionals and pregnant women. India has recorded over 9 million cases, reporting 15% of global cases. Russia has had over 2 million cases, recording higher number of daily cases. South Africa remains the country with the highest number of cases in Africa, despite implementing the longest and one of the strictest lockdowns within the continent.

Lockdowns have had severe implications for output growth in these economies. The Chinese economy escaped a recession after stringent lockdown measures sank GDP by 6.8% y/y in Q1’20. The lockdowns paid off for the country as it witnessed a 3.2% y/y growth comeback in Q2’20 and sustained the momentum with a 4.9% y/y expansion Q3’20. The recovery was anchored on strict containment measures, fiscal support via tax cuts and increased expenditure alongside the surge in medical exports. China also saw its rate of infections fall from thousands in February to tens in December.

In South Asia, India posted its worst GDP outturn on record in Q2’20 with a 23.9% y/y decline as lockdowns overwhelmed businesses and jobs, alongside pre-existing pressures on consumption by a shadow-banking crisis. The effect of the pandemic on the dominant services sector led to a record 11.4% y/y downturn in the Brazilian economy despite emergency responses by fiscal authorities. After a 1.6% y/y growth in the first quarter, Russia slumped by 8.5% y/y in the second quarter because of the effect of the pandemic on consumption and investment. Finally, South Africa lagged by -17.5% y/y and -6.1% y/y in Q2’20 and Q3’20 respectively owing largely to the strict lockdowns implemented to curb the pace of infections in the period.

Source: Bloomberg, Vetiva Research

Despite the broad-based slump across these emerging economies, a pick-up in economic activity was observed in Q3’20. Purchasing Managers Index surveys show production levels recovered following the reopening of economies. With the exception of Russia, these economies have recorded at least three consecutive months of expansion. Production levels in China continues to soar for eight consecutive months supported by buoyant exports and boost in infrastructure. While India’s production levels picked up in Q3’20, Brazil and South Africa have their PMI readings above 60pts reflecting the pace of economic recovery. Russia’s manufacturing PMI contracted in 9 out of the past 10 months as production levels were weighed down by resurgence of COVID-19 cases, which necessitated reinstitution of containment measures.

Manufacturing PMIs for BRICS (Jan - Nov 2020)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov
Brazil	51.0	52.3	48.4	36.0	38.3	51.6	58.2	64.7	64.9	66.7	64.0
Russia	47.9	48.2	47.5	31.3	36.2	49.4	48.4	51.1	48.9	46.9	46.3
India	55.3	54.5	51.8	27.4	30.8	47.2	46.0	52.0	56.8	58.9	56.3
China	50.0	35.7	52.0	50.8	50.6	50.9	51.1	51.0	51.5	51.4	52.1
South Africa	45.2	44.3	48.1	46.1	50.2	53.9	51.2	57.3	58.3	60.9	52.6

Source: Bloomberg, Vetiva Research

The fall in demand, occasioned by the lockdown kept inflation low in the first half of 2020 across the BRICS bloc. The slight recovery in oil prices drove inflation in the second half of the year. While Russia’s inflation was driven by monetary easing; higher food and energy prices drove consumer prices in Brazil and India. The slump in oil prices caused inflation to fall below South Africa’s target for the first time in fifteen years, while Chinese inflation was down for most of 2020 due to weak consumer demand.

MINT – Reeling under the pandemic

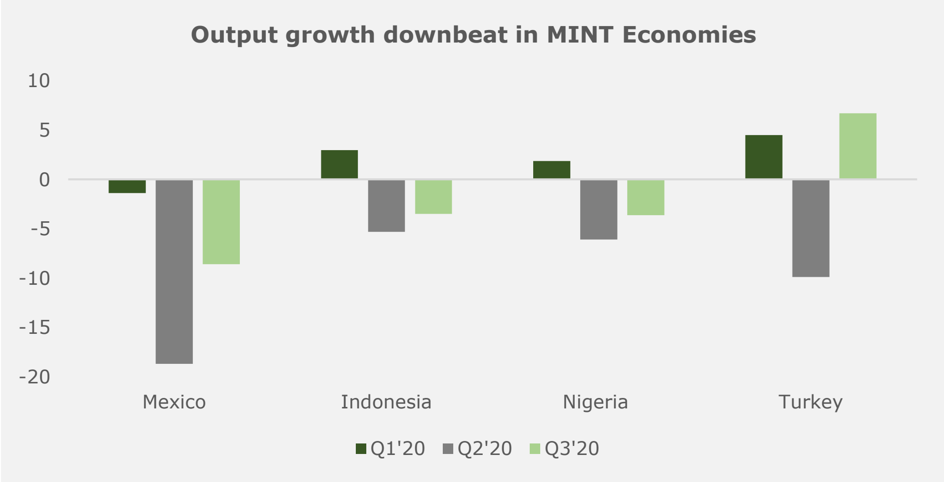
Like the BRICS economies, the MINT economies are profiled for immense potential to achieve rapid economic growth due to favourable demographics and economic endowments. With the armoury of a large young population, these economies have the potential human capital to man growth in the future, when many advanced economies will struggle with ageing population. The MINT economies also benefit from their geographical locations with Mexico sharing borders with the US; Indonesia in the most easily assessed tropical region and Turkey's strategic location between Europe, Central Asia and the Middle East. Over the years, these economies have been unable to deliver double digit growth due to lack of institutions, dependence on commodity exports and volatile portfolio flows.

Despite recording the fourth highest number of cases, Mexican health authorities acknowledged the country's death toll could be higher than reported. The country recorded the fourth highest number of cases in Latin America and coincidentally the fourth highest death toll in the world. With over 1,000,000 cases, the health system in the country has been stressed as the country's testing capacity was limited. Off to South-East Asia, the outbreak of the pandemic made Indonesia the second most hit country in the region. Due to the ravaging impact of the pandemic, a lot of Indonesians signed up to take part in the clinical trials of one of the vaccine candidates.

In Africa, Nigeria's COVID situation has been felt more on the economic front than health-wise. The country, like many Sub Saharan African countries has recorded significantly lesser COVID-19 related cases and deaths, when compared to peers in Latin America and South Asia. While this could be attributed to lower testing capacity, the country is yet to record a spike in cases with barely 66,000 infections and 1,000 deaths. Cases in Turkey surpassed 400,000 despite reports of excluding asymptomatic patients from the caseload.

These economies have had a fair share of pandemic-related output losses in Q2'20. With Mexico (-18.7% y/y) recording the sharpest downturn in Q2'20, the economy was already in a recession before the pandemic struck due to delay in the ratification of a trade deal with the US and Canada. In Q3'20, the economy continued its recessionary path with an 8.6% y/y contraction as both manufacturing and services sectors underperformed. Turkey recorded a 9.9% y/y slump in GDP as manufacturing, exports and services bore the brunt of pandemic-induced lockdowns. However, a swift recovery in household spending, investment and government expenditure propelled a 6.7% y/y recovery in Q3'20, despite weak external demand.

Another country with outcomes like Turkey's, Nigeria, was hit hard by nationwide lockdowns and movement restrictions which severely hurt economic activities during the second quarter of the year, culminating in a -6.10% y/y contraction in the period. Despite the reopening of the economy, voluntary and involuntary social distancing restrictions, the dual devaluation of the Naira, and the partial implementation of structural reforms dragged the economy into a recession in Q3'20 (-3.62%). Finally, Indonesia experienced its first recession since the Asian financial crisis having recorded two consecutive output contractions in Q2'20 (-5.32%) and Q3'20 (-3.49%) due to the slump in consumption spending, postponement of investment and fall in exports.



Source: Bloomberg, Vetiva Research

Unlike BRICS, manufacturing activity remained sluggish in the MINT economies for a substantial part of 2020. Except Turkey, these economies have recorded sluggish economic activity for at least six months. Production activities has remained slow in Mexico, which is yet to record a PMI reading above 50 points as the virus muffled demand, production and employment. Nigeria's production level was held back by the weakness of the Naira and supply chain disruptions. Meanwhile Indonesia's pick up in August was short-lived as tighter restrictions emerged after spike in COVID-19 cases. Turkey outstrips other MINT economies as local demand recovered and export orders have been on the rise.

Production levels subdued in MINT, ex-Turkey

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov
Mexico	49.0	50.0	47.9	35.0	38.3	38.6	40.4	41.3	42.1	43.6	43.7
Indonesia	49.3	51.9	45.3	27.5	28.6	39.1	46.9	50.8	47.2	47.8	50.6
Nigeria	60.8	59.2	58.3	51.1	42.4	41.1	44.9	48.5	46.9	49.4	50.2
Turkey	51.3	52.4	48.1	33.4	40.9	53.9	56.9	54.3	52.8	53.9	51.4

Source: Bloomberg, Vetiva Research

Macroeconomic themes in 2021

- **COVID-19 Vaccine and Second Wave concerns**

Increased social interactions since reopening of economies, gave impetus to rising coronavirus cases. As a result, some parts of Europe, including the United Kingdom have re-introduced curfews and lockdowns to stem the growth in infection cases. The rapid rates of infection could further stress public health systems in these countries, and erase economic gains made by the reopening. While the UK parliament has ratified lockdown measures, Spain declared a national emergency including over-night curfews to curb the spread of the virus and prevent overwhelming its health system.

In the race to get a vaccine, several candidates had to suspend their clinical trials after unexpected illnesses occurred in participants. Towards the end of the year, vaccine development hit a major milestone with the results of the first independent analysis of Pfizer and BioNTech's vaccine. The vaccine was reported to have prevented 90% of infections in participants, surpassing the 50% target set by the US Food and Drug Administration. A similar announcement was made by Moderna, a week later. At this pace, the world could have a vaccine ready by early 2021, as the pharmaceutical companies are already in talks with the US, UK and EU for supply of the vaccine. The arrival of a safe and effective vaccine will be pivotal to the recovery of the global economy in 2021.

• **US-China tensions**

Trade tensions has implications not only for the US and Chinese economies, but also for other economies due to the increased pace of globalization. While the trade war subdued China's economic growth to a 30-year low, the heated trade environment sliced US manufacturing output by the deepest amount in a decade. Despite the heated tensions between the two, China re-emerged as the US' largest trading partner as tariffs on medical equipment were relaxed, due to health implications. During the second half of 2020, the Donald Trump-led administration extended its tensions from trade to technology, as restrictions on export of key technology equipment were imposed and Chinese companies were asked to sell their US-based subsidiaries to American companies.

Following Joe Biden's victory in the US elections, there are indications that trade tensions may not deteriorate severely due to the multilateral and diplomatic approach a Biden presidency will adopt. However, Biden communicated reluctance to sign up new trade agreements until major investments are carried out in the United States. This could delay recovery in Mexico and other countries, awaiting ratification of trade agreements. The Democrat equally frowned at intellectual property theft and cyberattacks, which implies that trade tensions could swell. Thus, US-China relations will form a key development to observe in 2021, as trade recovers.

Sub-Saharan Africa Economy

Confronting parallel battles

The twin shock posed by the pandemic on the lives and livelihoods of Africans has amplified the continent's vulnerabilities. Although, low testing capacity coupled with favourable age distribution seemingly explain the region's less fatal death outcomes compared to the rest of the world, the pandemic's butterfly effect is still evident in the region. The collapse in key commodity prices, weakness in external demand and slump in foreign inflows has had severe implications for the real, fiscal, monetary and external sectors of Sub Saharan African (SSA) economies, which rely on commodity exports, foreign investments, tourism receipts and remittances.

The disruption in supply chains caused by the lockdown raised pricing pressures within the region. Despite the resilience of the agricultural sector, food prices went up majorly in oil-rich economies. On the other hand, lower energy prices occasioned by the fall in international oil prices yielded low inflation outcomes in non-oil or diversified economies such as Ghana and Kenya. Nigeria and Angola witnessed continuous build-up in inflation due to reforms and currency weakness.

The fall in economic activity during the year implied lower tax and export revenues, upturning fiscal and trade balances. The slump in exports and disruption of trade supply chains further constrained the capacity of several indebted SSA governments to implement sizeable stimulus measures. Thus, many countries in the region have resorted to borrowing, to finance expansionary budgets aimed at cushioning the economic consequences of the pandemic. Ghana and Gabon were the only economies that raised funds from the Eurobonds market in 2020 as Nigeria shelved its Eurobond plans.

Attempts by Chad and Zambia to restructure debt heightens the possibility of further credit downgrades in the region. The tripartite impact of risk-off sentiments, high deficit and debt levels and possible credit downgrades has kept SSA sovereign bond yields high and deterred fundraise in the Eurobond market. Thus, SSA countries have had to depend on official financing from International Financing Institutions (IFIs) to build up their reserves, respond to Balance of payment (BoP) needs and finance their budgets. The International Monetary Fund (IMF) estimates that the region may experience a BoP gap of $290billion if private financial flows remain below pre-pandemic levels.

Based on estimates from the World Bank, the pandemic is expected to push between 40 to 60 million Africans into extreme poverty, 27 million of which are in SSA. In line with the Bank's opinion, we believe the pandemic will drag the region to its first recession in 25 years informing a -3.22% y/y slump (World Bank: -3.2% y/y; IMF: -3.0% y/y) due to the severe contractions in Nigeria and South Africa, which jointly account for close to half of the region's GDP. Resource-intensive economies are expected to face negative growth outcome while diversified economies could record positive but slow output growth as consumer wallets remains depressed, global supply chains remain disrupted and manufacturing activity remains slow.

A modest recovery is expected in 2021 (Vetiva: +3.33% y/y; World Bank: +2.10% y/y; IMF: +3.07% y/y) due to a less likelihood of stringent lockdowns measures that could grind the region's economy to a halt. This bodes well for our expectation of sustained recovery in commodity prices and tourism, that will by extension provide momentum for a pick-up in consumption and investment across the region. As a result, the IMF expects regional inflation to rise to 10.6% y/y in 2020 (2019: 8.5% y/y) before moderating to 7.9% y/y in

2021, on the back of sustained recovery in oil and tourism receipts and its attendant impact on the region's local currency rates.

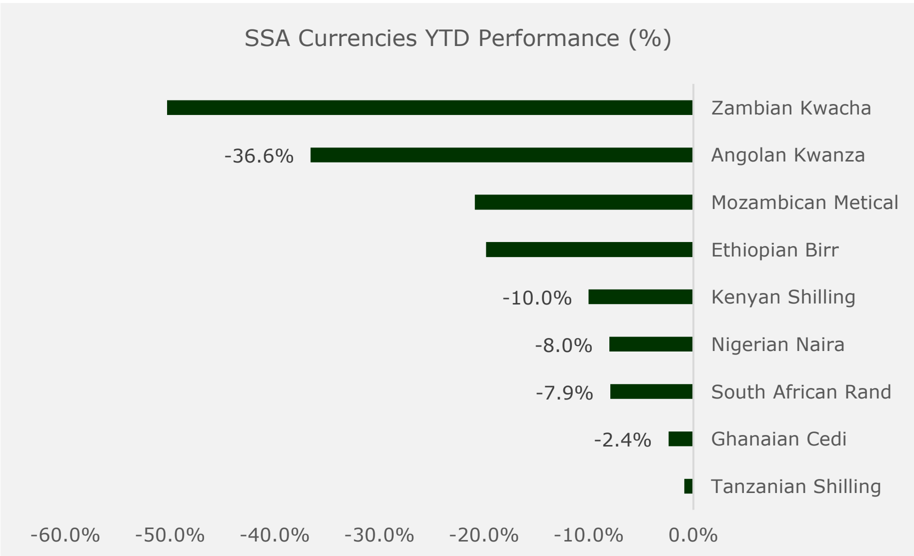
Amid weak external demand and slow recovery in commodity prices, the IMF projects that the region's current account deficit could expand to -4.8% of GDP (World Bank: -6.9%) in 2020 before moderating to -4.1% (World Bank: -4.9%) of GDP in 2021. A possible recovery in oil prices in 2021 could support the current account position of oil exporters while slow demand and dependence on imports for postponed construction activities may keep current account deficits elevated in metal-rich countries.

Fiscal deficits across the region are also on course to widen in 2020 but could narrow slightly in 2021. Expected broad-based economic recovery in 2021 is likely to ease fiscal pressures through higher tax and resource receipts, even though more fiscal injections may be required to stimulate aggregate demand. In addition, SSA countries could be faced with high costs of deficit financing in 2021, due to impending credit downgrades and potential risk-off sentiment.

SSA currencies teeter on FX liquidity constraints

Portfolio outflows, coupled with low export receipts, increased pressure on SSA currencies, raised volatility in floated currencies and strained currency pegs. Since the adoption of a flexible exchange rate regime in October 2019, the Angolan Kwanza has continuously weakened against the dollar while the flexibility of the South African rand continues to be tested with global downcycles. The petrocurrency status of the Nigerian Naira resulted in pent up pressure on the currency, amid a sharp decline in FX inflows and frantic efforts by the Central Bank of Nigeria to manage FX liquidity. The resulting pressure in the Nigerian FX market compelled a double adjustment of the official Naira exchange rate, the second adjustment being a pre-condition for assessing a World Bank dollar facility.

The Kenyan Shilling lost its ground on increased dollar demand, by Kenyans and Rwandans, amid a rise in imports and a lustreless outlook for exports in the wake of renewed lockdowns in Europe, following a second wave of COVID-19 infections. The move by the Central Bank of Kenya (CBK) to prevent the Shilling from depreciating to levels that destabilize the financial markets (by propping it up using reserves asset) has resulted in the depletion of reserves to $8.22 billion in Oct'20. The Ghanaian Cedi has outperformed many SSA currencies due to interventions by the Bank of Ghana (BoG), on the back of their commitment to keep the currency within a tight range since April, as well as the country's diversified export base, despite election risks.



Source: Bloomberg, Vetiva Research

Monetary policy bias for growth

The region was not left out of the global easing cycle embarked upon by most Central Banks earlier in the year as they prioritized the recovery of their various economies, notwithstanding the prevailing risk-off sentiments. From a 450bps cut in Cape Verde to a 50bps cut in Rwanda, SSA countries delivered rate cuts to cushion the adverse impact of the pandemic on their economies. However, Angola and Democratic Republic (DR) of Congo were unable to deliver rate cuts, the former due to its fragile economic situation and the latter due to inflationary concerns.

Countries such as Botswana and Namibia provided moratorium periods on loan repayments to ease payment burden on households and firms. In addition, restructuring of loans was put in place in several SSA countries including Botswana, Nigeria, Kenya, Ethiopia, Eswatini & Uganda. South Africa also implemented loan guarantee programs to support small and medium scale enterprises. Within the region, we have also witnessed the loosening of reserve requirements to boost money supply, purchase of government securities to improve liquidity in the capital market and support capital raise by companies.

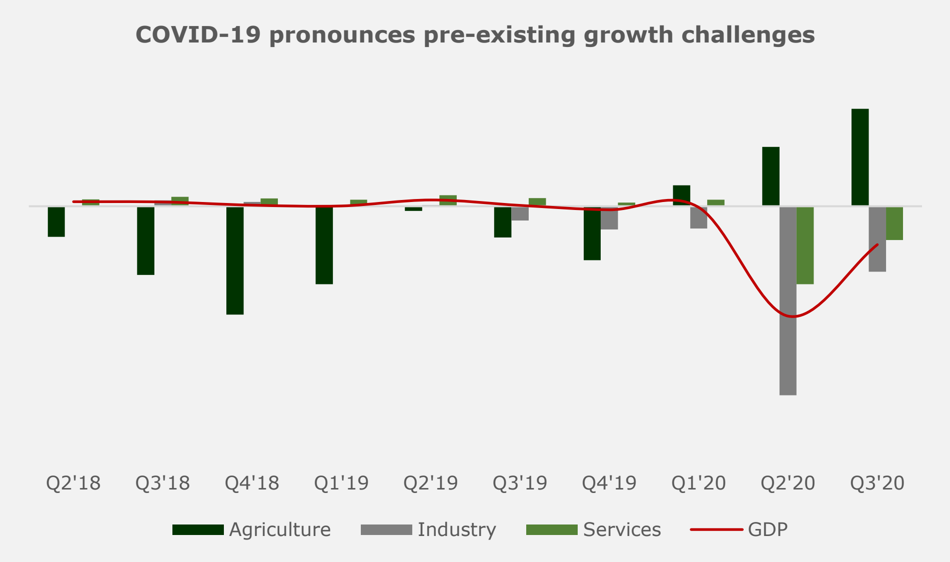
In the coming year, we expect the region's monetary policy to be predominantly accommodative to provide support to economies in recovery. However, a few of the region's countries with some monetary policy space (Ghana, Kenya and South Africa) could take advantage of extended low rates in advanced economies and further lower their domestic interest rates, in a bid to accelerate economic recovery. Amid the pervasive low interest rate environment, investors are likely to err on the side of caution as a balance between expected risk and return drive investment decisions. However, success in vaccine discovery and administration could trigger risk-on sentiments during the year if commodity prices pick up considerably.

COUNTRY	RATE (%)	YTD (bps)
CAPE VERDE	1.00%	-450
ZAMBIA	8.00%	-350
LESOTHO	3.50%	-300
SOUTH AFRICA	3.50%	-300
ESWATINI	3.75%	-275
NAMIBIA	3.75%	-275
GAMBIA	10.00%	-250
MOZAMBIQUE	10.25%	-250
NIGERIA	11.50%	-200
SEYCHELLES	3.00%	-200
UGANDA	7.00%	-200
GHANA	14.50%	-150
KENYA	7.00%	-150
MAURITIUS	1.85%	-150
SIERRA LEONE	15.00%	-150
BOTSWANA	3.75%	-100
MOROCCO	1.50%	-75
RWANDA	4.50%	-50
ANGOLA	15.50%	0
CONGO, DEM. REP.	18.50%	950

Source: Bloomberg, Vetiva Research

South Africa: Painful path to recovery

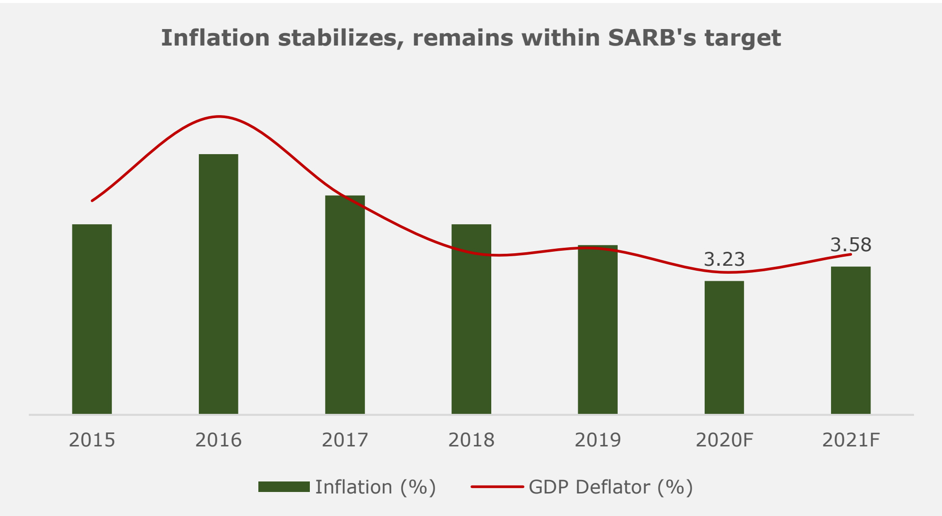
Pre-pandemic, weak private investment, consumption, and productivity have consistently contributed to the South African economy's sluggish growth. With the highest number of coronavirus cases on the continent, the country implemented some of the strictest restrictions in the world as citizens were not allowed to leave their residence except for essential purposes such as grocery shopping and medical care. This resulted in a record -17.5% y/y contraction in Q2’20 as 8 out of 10 sectors contracted, led by the real estate, trade and manufacturing sectors.



Source: Bloomberg, Vetiva Research

In the wake of the global pandemic, the South African government announced a $26 billion (R500 billion) stimulus package in response to the pandemic, which amounts to 10.3% of the GDP, higher than its SSA peers. The stimulus package entailed a loan guarantee scheme, job creation and support for SMEs, tax deferrals, holidays and extensions, a six-month support to vulnerable households, wage protection, health, and other frontline services as well as support to municipalities.

Inflation fell below the Bank’s inflation band during the first half of 2020 due to the impact of low oil prices on fuel. However, the recovery in oil prices and increase in electricity tariffs triggered pricing pressures in the second half. The low inflationary outcome gave impetus for monetary easing in South Africa and the South African Reserve Bank (SARB) reduced the repo rate by a total of 300bps to support recovery.



Source: IMF, Vetiva Research

The SARB also introduced overnight supplementary repo operations, adjusted corridor rates around the reference rate and raised the size of weekly financing operations. The resumption of government bond purchases in the secondary market was put in place to support market liquidity. Furthermore, the SARB extended refinancing maturities from 7 days to 12 months to further buoy liquidity in the money market. In addition, guidelines on debt relief to bank customers were issued to alleviate the impact of the pandemic on households and firms.

According to the United Nations Development Programme (UNDP), the country may take at least five years to recover to pre-pandemic levels. True to that, we expect the South African economy to contract by 7.25% y/y (IMF: 8% y/y) in the current year and recover slightly in 2021 by 0.46% y/y (IMF: 3% y/y). While a lower wage bill could curtail demand-driven inflationary pressures, higher energy prices would drive inflation north in 2021. As such, we expect inflation to average 3.23% y/y (IMF: 3.33% y/y) and 3.58% y/y (IMF: 3.87% y/y) in 2020 and 2021, respectively. A projected recovery in oil prices and inflation rising to the mid-point of the SARB's target could stall any further easing action from the apex bank, but the bank could take advantage of extended low rates in advanced economies and further lower its domestic interest rates to accelerate economic recovery.

More fiscal stimulus is expected in 2021, as the government unveiled a recovery plan late in 2020 to spur economic recovery from the historic slowdown. The economic plan is expected to cover eight priority areas including energy security, localization through industrialization, food security, investment in infrastructure, tourism, green interventions, public employment, gender equality and policy interventions. The plan outlines three execution phases – the immediate phase, which focuses on protection of livelihoods; the medium phase, which focuses on recovery of the economy and the long-term phase, which focuses on growing and transforming the economy.

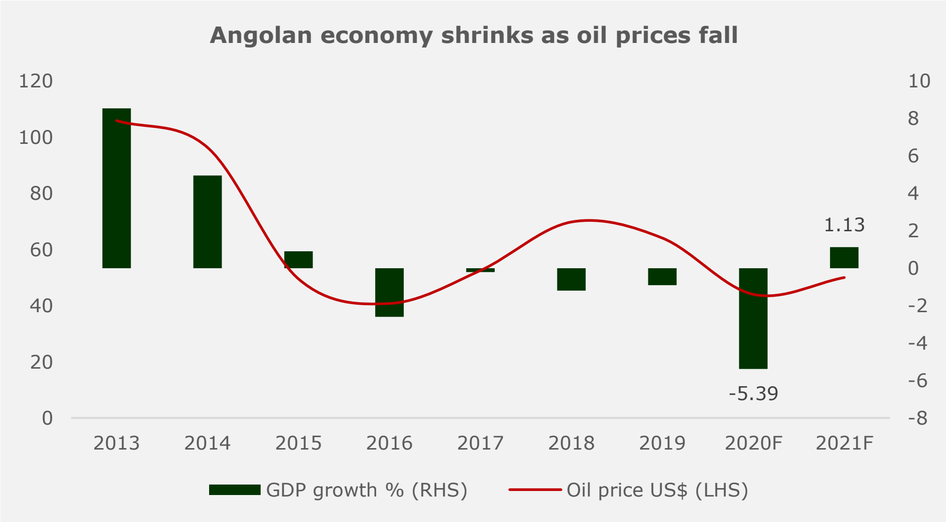
The IMF projects that it will take two years for government revenue to return to pre-COVID levels. Amid the pressure on revenues, there is a clamour for public wage increases by labour unions, following the decision of the finance minister to reduce the public sector wage bill. Consequently, we believe South Africa's fiscal stance in 2021 will remain expansionary, amid lower resource and tax receipts. This could result in wider fiscal deficits and higher debt levels, that could prompt fixed income investors to demand higher premiums for their investment. The IMF already projects that the country's debt level could ascend from 62.1% of GDP in 2019, to 78.8% and 82.8% of GDP in 2020 and 2021, respectively.

In a recent review, Fitch Ratings downgraded South Africa's long-term foreign-currency issuer default rating (IDR) to BB- with a negative outlook from BB with a stable outlook. Moody's delivered a similar downgrade to Ba2 from a previous rating of Ba1, while maintaining a negative outlook for the country. The recent downgrades sank South Africa's long-term foreign currency instruments deeper into junk territory and would not only have implications for the country's borrowing costs but will also retrograde the country's fiscal consolidation efforts.

The IMF also expects South Africa's current account balance to narrow to -1.62% of GDP in 2020 (2019: -3.02%) supported by a higher pricing for gold - which is a key export commodity - alongside the weakness of the rand. Going into 2021 however, the Fund expects a higher current account deficit (-1.80%) due to a pick-up in import demand as the economy emerges from a lockdown and economic activity resumes.

Angola: Collateral damage of the pandemic-induced dent on oil, China

Since the oil price crash in 2014, the Angolan economy has remained in doldrums as low oil prices and high levels of indebtedness crippled growth in the country. Like Nigeria, oil makes up 95% of its exports and two-thirds of government revenue. The slump in oil prices grinded output growth from a pre-crisis 5-year average of 4.5% y/y to a slowdown during the oil price crash of 2014/2016, before a protracted contraction which has lasted since 2016.



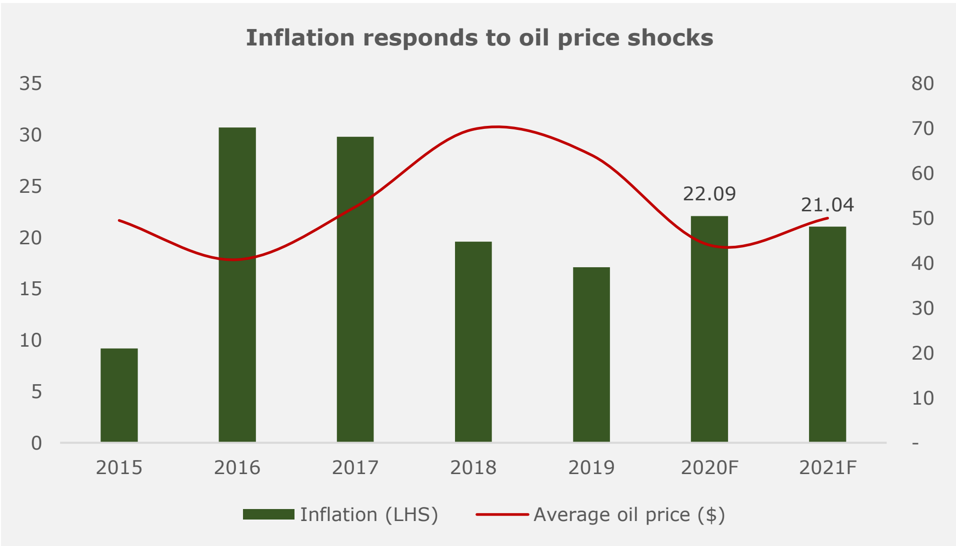
Source: NBS, Vetiva Research

To combat the ongoing pandemic, a number of fiscal reforms were put in place including the extension of corporate income tax deadlines, exemption of VAT and duties on donated goods, a 12-month VAT tax credit for imported capital goods & essential raw materials, and deferred payment options for social security contributions & urban property taxes. The country also applied a 30% freeze on its goods and services budget, reduced the number of ministries from 28 to 21 and suspended non-priority social support programs, alongside travel and real estate investments. Hiring of new civil servants was also put on hold, except for essential staff. Purchases of new vehicles for personal use was also suspended, the export of essential goods was withheld for a few days while prices of COVID-related medical goods were regulated.

Like Nigeria, Angola adjusted its budget benchmark oil price downwards from $55/bbl to $35/bbl. This, in addition to a slowdown in economic activity, signaled fiscal pressures for the government as both oil and tax receipts were expected to decline sharply. As a result, Fitch downgraded Angola's credit rating – for the second time in the year - further down the junk zone, as both fiscal and external buffers were being stretched. This triggered fears that the country's Eurobonds will be restructured, resulting in a massive jump in fixed income yields in September. However, a government pledge to honor its debt obligations caused yields to moderate slightly shortly after. In view of the facts that the downgrade in Angola's credit rating will make commercial borrowings expensive and debt levels already exceed 100% of GDP, the Angolan authorities negotiated with bilateral creditors like China and its lenders, taking advantage of the Debt Service Suspension Initiative.

The current account balance of Angola has been in the surplus region since 2017 due to lower imports and weakness of the Kwanza. While the import substitution strategies implemented by the government has helped to keep the current account in surplus region, the floating of the Kwanza has moderated external vulnerabilities. The weakness of the Kwanza can be traced to the initial removal of the currency peg at the beginning of 2018, when FX interventions and priority lists resulted in the depletion of external reserves and overvaluation of the Kwanza. Controlled adjustments in the Kwanza re-surfaced in the fourth quarter of 2018 following an inflow of $3.7billion funding from the IMF. The move resulted in further depletion of external reserves and a 20%-40% gap between the official and parallel exchange rates. Since October 2019, the currency has been floated and has depreciated by as much as 70%.

Efforts to stop illegal mining and lower FX sales limited the ability of the National Bank of Angola (BNA) to narrow the gap between the official and parallel market rates. Therefore, as part of its FX reforms, the BNA intends to limit its interventions in the FX market while allowing the market to determine the exchange rate via an electronic platform. The depreciating currency has contributed significantly to inflationary pressures in the economy, as inflation has risen consistently in 2020. Due to the persistently high inflation, Angola is the one of the two African countries that is yet to deliver a monetary policy rate cut in 2020, amid global easing cycle aimed at cushioning the economic impact of the pandemic.



Source: IMF, Vetiva Research

The advent of COVID-19 has extended the 4-year long recession by another year, amid implementation of structural reforms. Given the country's external vulnerability, we expect the economy to slide by 5.39% y/y (IMF: -4.0% y/y) in 2020. This will be a fallout of tripartite effect of the pandemic on health, the economy, and the financial sector. Being a resource-rich country, the twin impact of lower oil prices and OPEC+ export reductions would also be contributory to the country's fifth consecutive year in recession. However, a slight recovery of 1.13% y/y (IMF: 3.2% y/y) is projected in 2021 due to the anticipated lower COVID-19 infections, continued implementation of import substitution strategies that spur domestic production, a rebound in agriculture output and increased public sector works. While the expected termination of OPEC+ production cuts could provide a buffer to the economy, extension of OPEC cuts could pose a key risk to Angola's economic growth.

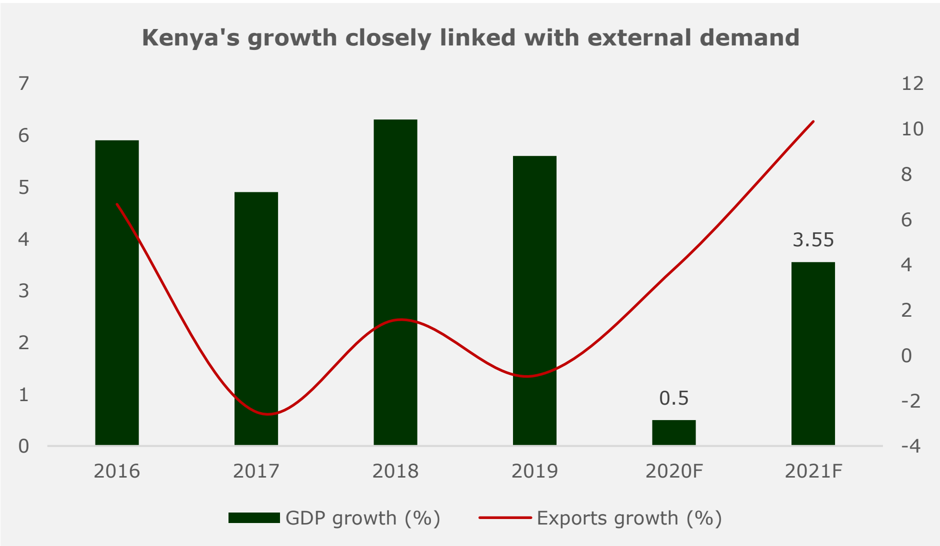
Angola's twin surplus, in both its fiscal and current account, is poised to swing into deficit for 2020. The slump in oil revenue, alongside COVID-related expenditure obligations would bring an end to its two-year budget surplus in 2020. With respect to non-oil earnings, we believe that reduced economic activity and tax relief measures would reduce non-oil revenues, but the introduction of a progressive tax system and elimination of tax exemptions could provide some support for non-oil revenue recovery. Nonetheless, Angola's fiscal deficit is expected to moderate to -0.13% of GDP in 2021 from a wider deficit of 2.81% deficit in 2020, as projected by the IMF. Unlike the fiscal balance that could remain in the deficit 2021, albeit slightly, the current account is expected to return to a surplus in 2021 (IMF: 0.11% of GDP). The upswing in the current account balance could be supported by higher oil prices and continued import substitution efforts. However, a shallow current account deficit is envisaged in 2020 (IMF: -1.30% of GDP), as external demand for oil remains depressed.

A recovery in oil prices could help re-anchor inflation, as volatility in the Kwanza could subside. Thus, inflation is expected to average 22.09% y/y (IMF: 21.0% y/y) in 2020, before slowing down to 21.04% y/y (IMF: 20.6% y/y) in 2021. The expectation of high inflationary pressures could, by extension, prevent the easing of monetary policy in the near term. We expect the tight monetary stance to persist for as long as it takes consumer inflation to moderate.

Considering the further downgrade of the Angola's credit rating, the country is unlikely to tap the Eurobond market to avoid higher premium payments. Inflows of foreign portfolio flows could also remain constrained, amid the uncertainty around oil price recovery. Therefore, we believe Angola could depend on multilateral flows to finance its balance of payment needs. Although, the intention to privatize some public entities could attract foreign direct investment and bolster reserve accretion, and the continued implementation of import substitution strategies could reduce pressure on the Angolan Kwanza going forward.

Kenya: Economy gears on recovery path

After recording a slower growth of 4.9% y/y in Q1'20 (Q4'19: 5.5% y/y), the Kenyan economy contracted by 5.7% y/y in the second quarter of 2020 due to movement restrictions, business closure and the drop in international trade associated with the COVID-19 pandemic. Though lower on a q/q basis, the magnitude of growth recorded in Q1'20 masks the impact of the coronavirus-induced slump on half-year GDP. This is attributed to the growth in the agriculture, real estate, and financial services sectors, which contributed close to 50% of the GDP.

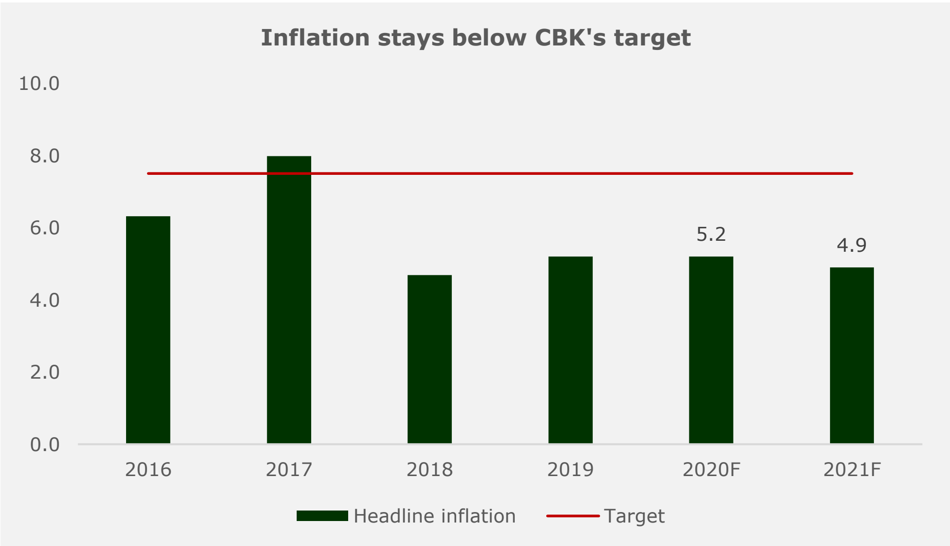


Source: NBS, Vetiva Research

In response to the pandemic, a supplementary budget was approved to make provision for emergency health spending, cash transfers to vulnerable groups, tax reliefs and VAT refunds. A 5% deduction was carried out on marginal and corporate income tax rates while turnover rates for small businesses and standard VAT rate were reduced by 1% and 2% respectively. The government also introduced an 8-point Economic Stimulus Programme worth $503mn (Ksh53.7 billion), which covers infrastructure, education, SMEs, healthcare, agriculture, tourism, environment, and manufacturing.

Financing its operations through commercial borrowings has raised concerns about its debt sustainability efforts, given the impact of pandemic on commodity exports. Due to rising risks of meeting its borrowing requirements and debt payments, Moody's revised its outlook on Kenya from stable to negative. A similar decision was taken by Fitch, which cited the weak track record of fiscal consolidation, deterioration in budget deficit and government's debt to GDP ratio as reasons for the downgrade.

Since the start of the year, Kenya's inflation has been on the downtrend – an extended impact of the slump in oil prices and lower food prices on general consumer prices. However, in October, inflation nudged higher to 4.84% y/y from 4.20% y/y in September. October's upswing in inflation was triggered mainly by a rise in the price of fuels and selected food commodity prices.



Source: IMF, Vetiva Research

Inflation remaining within the Central Bank of Kenya's (CBK) target of 2.5%-7.5%, provided a leeway for monetary policy to complement the government's expansionary fiscal stance aimed at cushioning the economic consequence of the pandemic. Consequently, the CBK eased the benchmark monetary policy rate by 150bps to a nine-year low of 7%. The Bank also lowered the cash reserve ratio by 100bps to 4.25% and extended maximum tenors for repurchase agreements to improve liquidity levels. These expansionary decisions were further deepened with increased flexibility for classification and provisioning of loans.

The economy is expected to return to growth in Q3'20 given optimistic PMI readings. The gradual easing of the lockdown in Europe led to a resuscitation in demand as new orders and export sales recovered. Thus, we expect a positive but slow growth of 0.50% y/y in 2020 (IMF: 1.0% y/y) before a 3.55% y/y growth in 2021 (IMF: 4.6% y/y). The recovery in external demand is expected to reduce its current account balance in 2020 to -4.89% of GDP (2019: -5.82%), according to IMF estimates. This could be due to a greater effect of lower oil prices on its import bill, than lower tourism receipts and exports. Higher oil prices could plunge current account into a deeper deficit come 2021, as the IMF projects a current account balance of -5.39% of GDP, despite an anticipated slow recovery in tourism and remittances.

On the fiscal front, fiscal consolidation is likely to be delayed because of the need to embark on emergency pandemic-related spending. On the back of a sharp drop in earnings and the weakening of the Kenyan Shilling, Kenya's fiscal deficit to GDP ratio in the current year is expected to deteriorate further to -8.4% of GDP, according to IMF projections, from -7.8% of GDP in 2019. In 2021, the current account could further deteriorate slightly to -8.5% of GDP, driven by pandemic and election-related expenditure. This could drive government's debt to GDP ratio further higher to 64.7% and 68.2% of GDP in 2020 and 2021 respectively, from 62.4% in 2019.

In the short to medium term, we expect inflation in Kenya to remain within the Central Banks target of 2.5%-7.5%. The impact of locust invasion on agricultural output could raise inflationary pressures on food items, alongside insufficient rainfall. However, we believe the slump in oil prices would have a softening impact on consumer prices, via lower fuel pump price. Consequently, we expect inflation to remain muted in 2020 at 5.20% y/y (IMF: 5.30% y/y). In 2021 however, the absence of a locust infestation could soften the pressure on food prices while a continued recovery in global tourism could ease the pressure on the Kenyan Shilling, and its passthrough impact to consumer prices. On the back of this, we could see a moderation in Kenya's inflation to 4.90% y/y (IMF: 5.0% y/y).

Properly anchored inflation expectations leave room for monetary policy action, in either direction, in response to global economic uncertainties. Therefore, should the risk of a coronavirus second wave crystalize, we could see the CBK easing its monetary stance further to provide some more support to the Kenyan economy amid new job losses, pay cuts and low business returns.

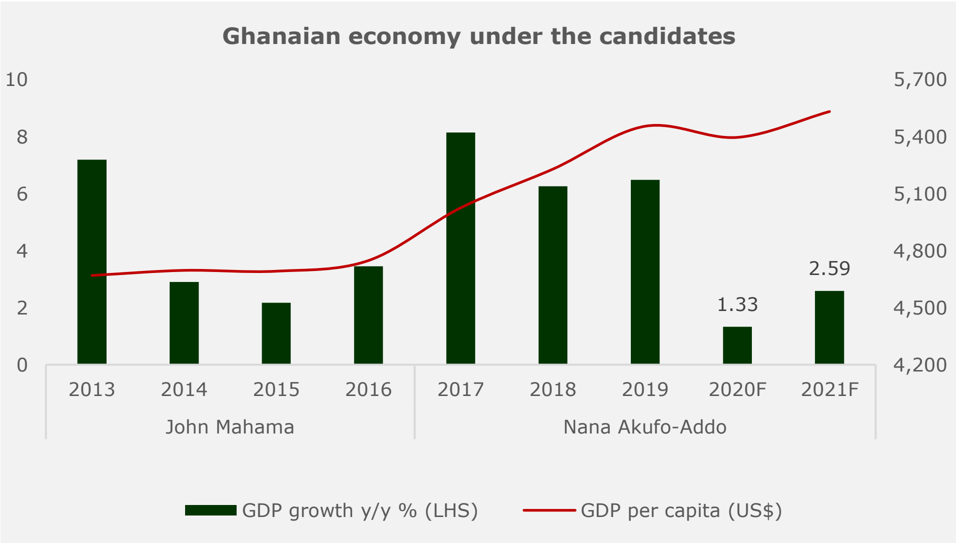
Ghana: Exports diversity to support resilience

As one of the fastest growing economies in the region, the Ghanaian economy has also been affected by the pandemic. Starting out with a 4.9% y/y output growth in Q1'20, lockdown measures yielded a -3.2% y/y slump in output in Q2'20 with hotel, trade, manufacturing, and mining sectors being the most affected. This represents the second time Ghana's economy would record a contraction since the 2016 elections, the first being in Q2'16. Sectors like the agriculture, construction and communication sectors recorded growth amid the downturn. While the agriculture sector grew slower (2.5% y/y) in Q2'20 in comparison to the corresponding quarter in 2019, both the communications and constructions sector grew faster at 74.2% y/y and 3.6% y/y, respectively.

Coincidentally, the country recently concluded its December 2020 polls, where 12 aspirants met in the Presidential elections, including the ex-ruler - John Mahama of the National Democratic Congress (NDC), and the incumbent president - Nana Akufo Addo of the New Patriotic Party (NPP). This was the third face-off between the two main contenders. The COVID-19 pandemic made the exercise difficult as sanitation and social distancing guidelines had to be adhered to during the biometric registration of voters. Between July and August, voters were registered while an online queueing platform was adopted for crowd control. Eventually, the incumbent president polled 51.3% of the total votes cast to secure a re-election into office.

Thus far, the economy has fared well, with an average growth rate of 6% y/y, under Akufo Addo's administration. The success achieved with the economy thus far has been supported by the higher pricing for oil in the global market.

While 59% of Ghanaians in pre-election opinions polls believed the economy was going in the wrong direction under Akufo Addo, economic indicators show otherwise as the country became the fastest growing economy in the world alongside achieving a single-digit inflation rate, with a relatively stable currency.



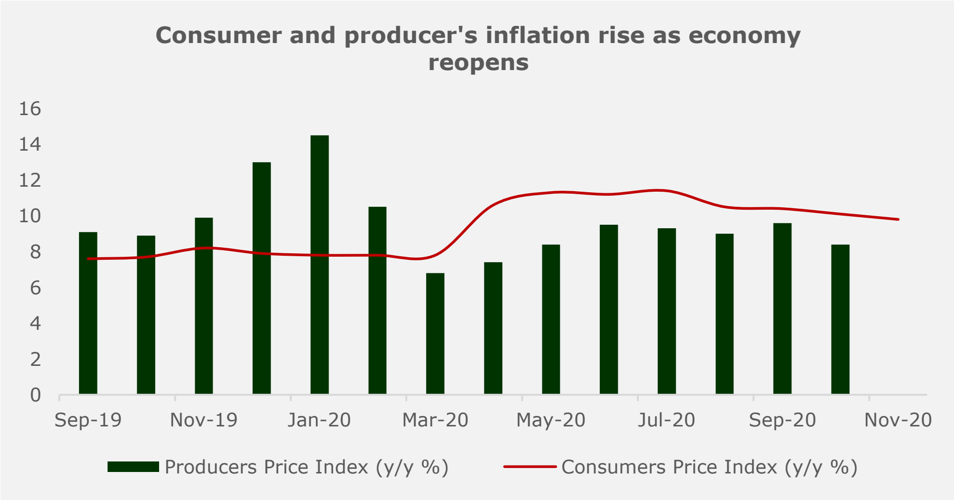
Source: IMF, Vetiva Research

Due to the pandemic, c.25% of the Ghanaian workforce experienced wage cuts while 42,000 employees were laid-off during the partial lockdown. In response to the socio-economic fallout of the pandemic, the government committed close to $200mn (GH₵1.2 billion) to address the pandemic- related issues via the Coronavirus Alleviation Program, and upgrade hospitals. The Coronavirus Alleviation Program (CAP) is a stimulus package designed to provide relief to small and medium scale enterprises (SMEs) that were impacted by the pandemic. In a show of fiscal discipline, the government also plans to reduce its spending on goods and services, transfers, and capital investment.

The slowdown in tax revenue and oil prices hit government revenues while extraordinary health-related expenditures were incurred to respond to the public health crises and reduce the impact of the pandemic on the vulnerable sectors of the economy. Thus, the 5% ceiling on deficit level for the 2020 budget had to be relaxed in a mid-year budget review while a higher deficit target of 11.4% of GDP was enacted. This would see the fiscal deficit-to-GDP ratio of the country cross 10% for the first time in six years. Sequel to the recovery in economic activities, there has been a gradual recovery in tax and export revenues, which is likely to prop up revenues in 2021.

Consistent with fiscal measures, the Bank of Ghana has used both conventional and unconventional policy measures to moderate the impact of the pandemic. These measures ride on earlier reforms in the monetary policy framework, clean-up in the financial sector and fiscal consolidation measures. The Bank reduced the benchmark rate by 150bps and introduced macroprudential responses such as a 2% reduction in reserve requirements. These measures resulted in improved credit to the private sector as lending rates were lower by c.2% compared to 2019.

While monetary policy remained expansionary, consumer prices were driven predominantly by other factors during the year. Inflation rose beyond the Bank's target (6% - 8%) in Q2'20 due to panic buying ahead of the lockdown. However, lower fuel and food prices resulted in a reduction in inflation in subsequent months. During the second half of the year, inflation continued to fall towards the Bank of Ghana's target range of 6%-10%, as core pressures eased, and pandemic uncertainties waned.



Source: GSS, Vetiva Research

With respect to the external sector, Ghana enjoyed trade surpluses for three consecutive years before the pandemic. However, the pandemic caused a slump in external demand for two of the country's key export commodities - crude oil and cocoa while the third key commodity - gold - has remained resilient because of its safe-haven status. In addition, the presence of Ghanaians in diaspora in the health sector has helped in stabilizing remittances, supporting the current account balance of the country. The early fundraise of $3.4 billion from the Eurobond market and the inflow of $1 billion from the IMF strengthened reserve position, improved BoP financing and allowed for a stable exchange rate. The build-up in external reserves has strengthened the Bank's interventions in the foreign exchange market, which has kept the Cedi within a thin range of GH¢5.7 - GH¢5.9/$.

Despite the pick-up in production activities during the third and fourth quarter of the year, the volatility in commodity prices and pandemic-induced pressure on domestic demand will slow the country's growth from a 5-year average of 5.3% y/y to a three-decade low of 1.33% y/y (IMF: 0.93% y/y) in 2020. Following the re-election of the incumbent president, we expect consolidation of fiscal and monetary measures towards quick economic recovery in 2021. Specifically, we expect continued resilience in the agriculture sector, recovery in trade, logistics and financial services to buoy the economy by 2.59% y/y in 2021 (IMF: 4.19% y/y). This will thrive on better containment measures that will propel recovery in the transport & storage sector, which had been disrupted by the stringent lockdowns in the first half of 2020.

With the passthrough of global containment measures to oil prices, the country's current account deficit could widen to -3.42% of GDP in 2020, reinforced by growing demand for imports as containment measures are eased. Eventually, the external sector will receive a boost from the recovery in oil prices, associated with vaccine developments and pick-up in industrial demand. This, alongside stable exchange rate and reliable remittance inflows would narrow the current account deficit to -2.25% (IMF: -2.92%) in 2021.

As a result of the lower oil exports and taxes, fiscal consolidation efforts of the Ghanaian government will be delayed as stimulus packages and health responses of the government swell public expenditure. Following the ratification of a larger fiscal deficit limit, the country could see its fiscal deficit rise to -14.9% (-16.4%) of GDP in 2020. However, economic activities would rebound in 2021 leading to improved tax and export receipts, lending credence to a moderation of FY'21 fiscal deficit to -8.86% (-9.26%).

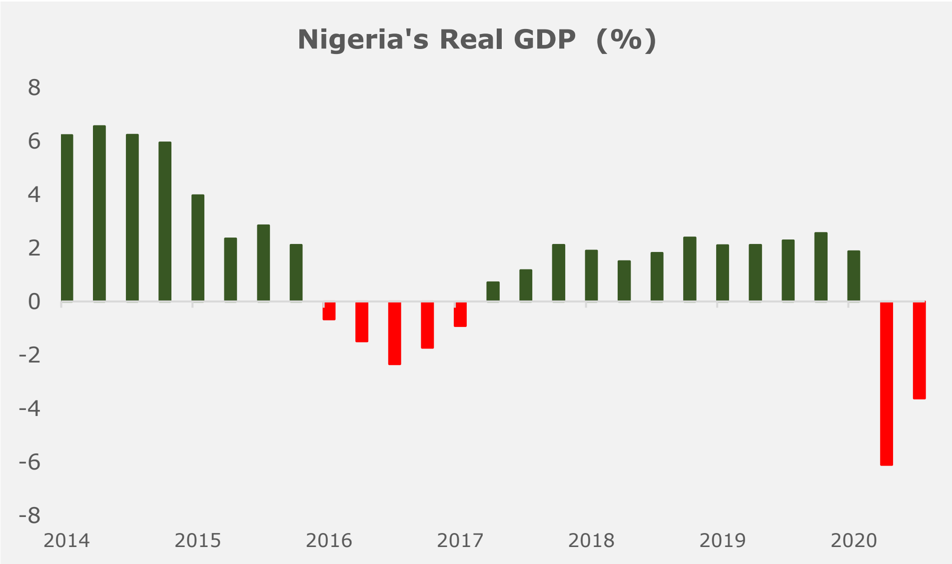
With the absence of disruptive lockdowns, inflation could slide towards the Central Bank's target in 2021. The high base year effect would cushion the pressures on commodity prices, as the broad economy recovers. As the agricultural sector expanded in 2020 despite the lockdown, food prices are expected to soften alongside the reduction in stockpiling. Thus, inflation is expected to fall from an average of 9.82% y/y (IMF: 11.61% y/y) in 2020 to 7.02% y/y (8.65% y/y) in 2021. The moderation will be supported by the managed exchange rate regime, which the Bank of Ghana adopted to keep the Cedi within a tight range. That said, a stable exchange rate environment will decelerate distortion in prices and foster better planning by households and firms.

Nigerian Economy

Pandemic's economic scars to linger

Real Sector: Off the cliff

The COVID-19 pandemic ended twelve quarters of positive output growth after the nation recorded its strongest quarterly growth, post-2016-recession, in the fourth quarter of 2019. While the delayed transmission of the adverse effect of the pandemic of the Nigerian economy resulted in slower growth of 1.87% y/y in Q1'20, the impact of the five-week lockdown reverberated across the country's economic sectors in Q2'20, causing a 6.1% y/y contraction in the second quarter and extended to Q3'20 in a -3.62% y/y contraction. Most of the economic sectors have seen a downturn in productivity year-to-date, with the deepest contractions seen in transport (-27.98% y/y) and leisure (-18.86 y/y) as of 9M'20. The financial, ICT, health, and agriculture sectors have remained resilient amid the slowdown in economic activities.



Source: NBS, Vetiva Research

The presence of OPEC quotas coupled with the slump in demand caused oil production to slide to a level last seen in 2016. Growth has been handicapped in the sector by frequent downtimes in key production lines and delay in the passage of Petroleum Industry and Governance Bill (PIGB). Despite moves in H2'20 to revive the bill and the implementation of reforms in the downstream sector, the slump in oil prices and social unrest – following recent protests – continue to restrain investment in the critical sectors of the economy.

Constrained activities in the transport sector rubbed off on other critical non-oil sectors of the economy such as construction, trade, education, and manufacturing, as they've seen record contractions as of 9M'20. The non-oil sector was also handicapped by the lockdown measures that curtailed production activity in the industrial sector. The manufacturing sector was dragged by the labour hour restrictions, disruption in supply chains, weakness of the naira and depressed consumer wallets.

The pandemic added to woes in the trade sector, which has been in a 4-year long recession. Trade had earlier been held back by the Apapa gridlock, which hindered the flow of goods while the closure of the land borders in August 2019 left trucks from neighbouring countries stranded. Social distancing measures, implemented to limit the spread of the virus, further constrained trade locally and contributed to the dampening of the sector's performance.

The slowdown in agriculture output growth to 1.39% y/y in Q3'20, from 2.20% y/y in Q1'20, also lends credence to the fact that transport restrictions weighed on the productivity of economic sectors. However, the sector's positive-growth outcome is supported by interventions and investments in the sector, further strengthened by the border closure policy, which has limited the supply of competing smuggled and foreign products.

Among the outperformers, is the ICT sector that has grown more in post-recession years than it did before 2016. The proliferation of financial technology initiatives, adoption of ride haling services and permeation of ICT into several sectors has aided continued expansion in the sector. Despite the under-whelming real GDP performance as of 9M'20, the ICT sector outperformed, delivering double-digit growth due to increased adoption of voice calls and data subscription during the lockdown. The shift in business continuity plans from physical offices to remote operations increased demand for technology services that enable remote work, including teleconferencing applications.

The financial services sector, which also outperformed in the period, has grown better every year since the 2016 recession. By virtue of the pro-lending policies, the sector is set to record its strongest yearly growth in a decade. The second term of the Central Bank Governor came with reforms that sought to curb banks' investment in high-yielding fixed income instruments at the expense of the real sector. Thus, banks were mandated to give out significant proportion of their deposits in loans with favourable weights attached to SMEs, retail, mortgage, and consumer lending.

Job market hits a pandemic low

After six quarters of data absence, unemployment data was revealed for the second quarter of 2020. As we note that it is possible to have jobless growth but unfeasible to have growthless jobs, the data showed that the unemployment rate rose to 27.1%, from 23.1% in Q3'18. The uptick in unemployment was consistent with the negative economic growth outcome recorded in Q2'20.

Source: NBS, Vetiva Research

The unemployment survey also revealed a shrinkage (-11.25%) in the size of the labour force to about 80 million people in Q2'20, from 90 million people in Q3'18. A drop in the country's labour force participation rate, despite its teeming youth population, also lends credence to unpleasant structural conditions in the economy such as prolonged years of study and a lack of viable opportunities that can attract and retain talent.

A continued rise in unemployment can cause a negative multiplier effect, by increasing social problems including financial hardship, debt, crime, and civil unrest. With youth (15-44 years) unemployment estimated at 30%, the adverse socio-economic effect could become even more pronounced as witnessed during the recent protests that claimed lives and property.

Bumpy, uneven economic recovery underway

A ripple effect of the pandemic is subdued economic activity in 2020. While the lockdown measures stifled growth in the industrial and services sectors, we believe the extended effects of the lockdown weighed on the overall economy in the current year. However, in 2021, we anticipate a slight recovery predominantly driven by this year's low base and supported by continued interventions to cushion the adverse economic impacts of the pandemic. It is also important to mention that in the event of a second wave of the coronavirus pandemic, we do not envisage the reinstating of strict lockdown measures in Nigeria. This, in addition to a medical solution to the virus, could provide some low-hanging fruits in the coming year. Consequently, we expect the Nigerian economy to contract by 2.68% y/y in 2020 (FY'19: 2.27%), before rebounding by 1.48% y/y in 2021 (IMF: 1.70% y/y).

Although the impact of the pandemic on the agriculture sector may be limited, due to large investments in the sector, we believe agriculture output growth could slow to 1.50% y/y (2019: 2.36% y/y) in FY'20. Restricted access to viable inputs during the 2020 planting season, on the back of transport and logistics restrictions, as well as reported flood and insecurity incidences, could weigh on the output from the agricultural sector even though ongoing government policies are largely pro-agriculture. In 2021, growth acceleration in the agriculture sector could be driven by the continued implementation of the government's pro-agriculture policies, continued interventions by the Central Bank, all on the back of 2020's favourable-base. However, ethnic clashes and adverse weather conditions remain pressure points that may affect the sector's output. As a result, we believe the sector could expand by 2.25% y/y in 2021.

The butterfly effects of the pandemic are still evident as the devaluation of the naira and the disruption of supply chains raise the cost of production amid weak consumer wallets. As such, the manufacturing sector is expected to reel from supply chain disruptions, FX challenges and weak consumer wallets. For most of 2020, the CBN's Purchasing Managers Index (PMI) surveys has shown a consistent slow-down in industrial activity as order and inventory levels remain subdued. In 2021, we do not envisage a dramatic positive change in the sector's drivers. Pandemic-induced job losses, and by extension declines in income, could further undermine consumerism amid the effect of double-digit inflation and a double devaluation on consumer prices. As a result, we expect the sector to grow slightly by 1.61% y/y supported majorly by 2020's low-base

With OPEC production cuts in place, headroom for growth in the oil sector – which makes up 98.56% of the mining sector - is limited. The production quotas are likely to directly limit the sector's output. In addition, a bleak outlook for oil prices and the continued impasse of the PIGB will continue to constrain the sector's productivity in the near term. Consequently, we expect the oil sector to contract by 4.34% y/y in 2021.

We believe the output constraints in the oil sector could dovetail to the non-oil sector, particularly the services sector through higher FX-related costs because of the devaluation. The transport sector could still be affected by voluntary and involuntary restrictions to enforce social distancing. Travel restrictions and border regulations could contribute to the woes in the transport sector, thus limiting transport sector growth to 8.95% y/y, in 2021.

Trade - which accounts for 15%-16% of GDP - is expected to remain in the woods, hindered by social distancing restrictions, border closure and export restrictions. The disruption in local supply chains, because of the pandemic, will further constrain growth in the trade sector. Likewise, the recent nationwide protests that culminated in the vandalization of property could also deter strong investment in real estate, amid unresolved socio-economic challenges. Therefore, we believe the real estate sector is on course to record its sixth year of contraction in 2021.

Meanwhile, the financial services and ICT sectors are expected to remain the high-flyers, as both sectors are on the beneficial end of the pandemic. A switch to technology-enabled business models will continue to support growth in the ICT sector while the global low-yield environment and the need to limit human-to-human interaction could support the financial services sector, through increased online activities and use of e-payment channels that could attract fees

Price rachets to persist on reforms

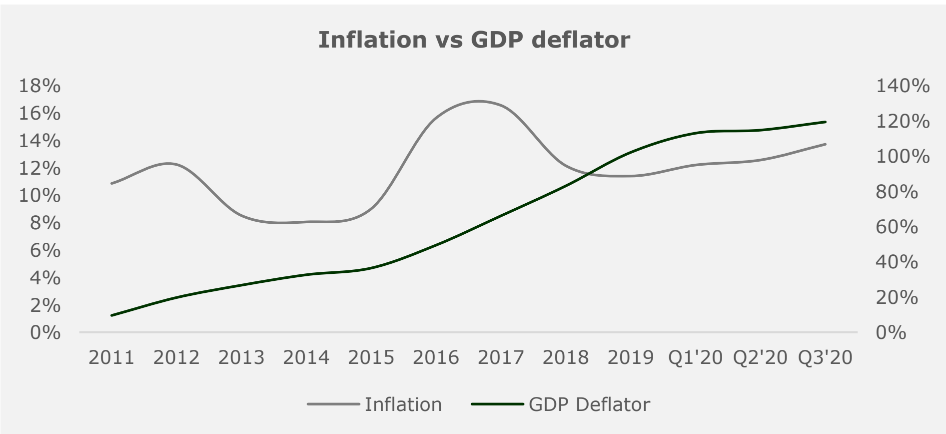
The onset of the pandemic triggered an invisible battle between the disinflationary impact of weak demand and struggling businesses looking to survive, and the inflationary impact of supply chain disruptions and capacity constraints. However, the latter seems to be holding sway in Nigeria, amid a surfeit of structural challenges.

Inflation in Nigeria has remained elevated since the introduction of border closure measures in the third quarter of 2019. The increase in Value Added Tax (VAT) from 5% to 7.5% also contributed to the buildup in inflationary pressures, despite the exclusion of some food items and necessities from the review. This was also amplified by panic-buying, that took place upon the announcement of nationwide lockdowns to curb the spread of the virus.

Supply chain disruptions also contributed to inflationary pressures, especially in food prices, as inventory levels could not be replenished in time. This was further accentuated by the exclusion of milk and maize from access to FX at the official window. The double devaluation of the Naira also added to pressures on consumer prices, as the local supply gap persisted.

The twin hike in electricity tariffs and pump price of Premium Motor Spirit (PMS) inflicted pressure on the housing, water, gas, and other fuels (HWGS) segment and spiraled into other segments of the Consumer Price Index. Health and transport inflation rose faster than other price segments, driven majorly by a surge in demand for health services and health care products, and the deregulation of the downstream sector, respectively. In addition, transport sector players have been forced to operate with stern capacity constraints and have resorted to lifting prices to make up, at least, part of the differential.

As at Nov’20 inflation was already up 291bps from Dec’19. Headline inflation in Nov’20 came in at 14.89% y/y, an effect of simultaneous pressure on both food and core prices. Both food and core inflation are up YTD, by 363bps and 172bps, respectively. Prices in the health and transport sectors continue to rise at a faster pace than prices in the other sectors, coming in at 13.57% y/y and 12.57% y/y, respectively in Nov’20.



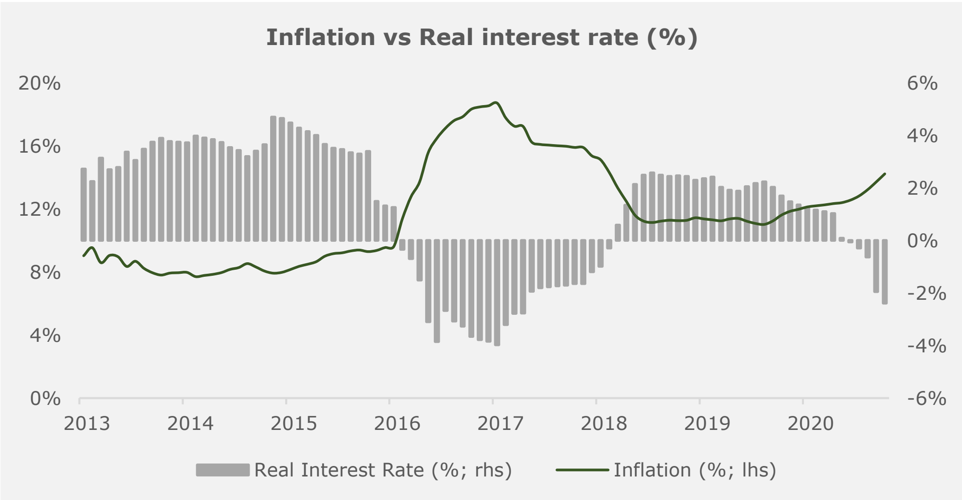
Source: CBN, Vetiva Research

Like the CPI-measured inflation, the implicit price deflator (GDP deflator) – that measures the level of prices of all new, domestically produced, final goods and services within the economy – also indicates a buildup in local price pressures. As at Q3’20, the GDP deflator reveals that prices of locally produced goods and services were higher by 8.56% from Dec’19 levels, higher than deflators 5.40% and 6.25% of Q1’20 and Q2’20 respectively. The continued rise in the deflator indicates the pressure on costs associated with the domestic production of goods and services, which are because of the country’s structural inadequacies.

Given the implementation of market-reflective PMS prices and service-based electricity tariffs, we believe headline inflation will trend north for a greater part of 2021. The passthrough effects of recent reforms in the energy and external sectors could propel headline inflation to average 13.22% y/y in 2020 (FY’19: 11.39%), while the continued implementation of those reforms could send headline inflation to an average of 17.53% y/y in 2021.

The regulation of the land borders and currency weakness inform our food inflation expectation of an average of 16.13% y/y in 2020 (FY’19: 13.73% y/y) while higher transport costs, as a result of market-reflective fuel prices, could quicken the food inflation average to 22.24% y/y in 2021, as oil prices extend their recovery. Additional cost pressures could stem from the pandemic as increased cleaning regiments, social distancing measures, and reduced capacity limits could be costly, pressuring inflation further if consumers are willing to pay more.

Monetary policy: Time for a breather?



Source: CBN, Vetiva Research

Despite the persistent rise in inflation, monetary policy has been largely expansionary as the stance of the Central Bank is bias in favour of economic growth. The bank prioritized economic recovery amid the policy trilemma of a coronavirus-induced recession, rising inflation and a fragile external position. Consequently, the Monetary policy Committee (MPC) of the Central Bank delivered two rate cuts of 100bps each at their May and September meetings. The 6.10% y/y slump in economic activities in Q2’20 suggested the need for a deeper rate cut, which the MPC delivered in Sep’20. This brought the benchmark interest rate, Monetary Policy Rate (MPR) to 11.5% from 13.5% at the start of the year.

Along with September’s rate cut, the MPC adjusted the corridor rates to buttress the pro-growth stance of the CBN. The corridor rate, around the MPR was adjusted from +2%/-5% to +1%/-7% around the MPR to discourage saving and drive consumption. In a similar move, the apex bank lowered the floor on the savings deposit rate to 1.25% p.a. from 3.75% p.a., a direct move to drive down the risk-free flexion rates (such as the savings deposit rates and fixed deposit rates), even as inflation continues to tick higher.

On one hand, we believe the CBN wielding the axe on interest rates was a move was carried out to improve lending to the real sector and simultaneously moderate interest expenses of banks, especially after a restructuring exercise that affected 41% of loans in the banking industry. On the flip side, the move implies a negative carry, as the consistent rise in inflation continues to erode the real value of fixed income investments in the prevailing low-yield environment.

The CBN also responded to the adverse effects of the pandemic by reducing interest rates on intervention facilities, extending moratoriums, providing credit support to players in the health care industry, creating a ₦50 billion targeted credit facility and granting regulatory forbearance to commercial banks to aid loan restructuring. As of September 2020, the Bank had disbursed a total of ₦3.5 trillion in response to the pandemic. The Bank also stated that it will contribute over ₦1.8 trillion to the ₦2.3 trillion Economic Sustainability Plan (ESP) through its financing intervention windows to economic sectors.

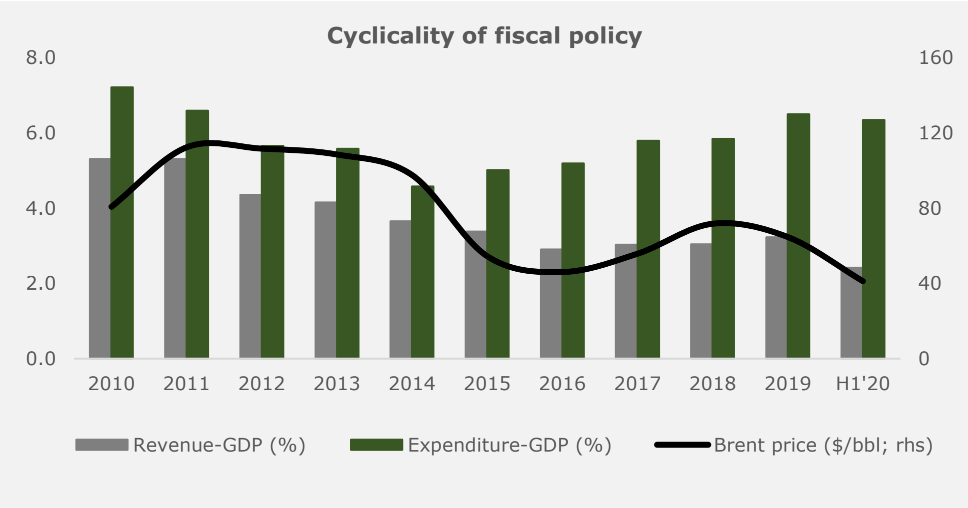
The overall posture of the bank has been to encourage consumerism. As stated previously, when people spend more on goods/services produced in a never-ending cycle, the economy grows. This we believe has been the basis for the CBN’s monetary policy actions this year. We do not envisage a radical shift in this stance in the near term, while we believe near term rate actions by the apex bank will be data driven. We believe the MPC will be accommodative in 2021, however worse than anticipated economic growth outcomes could trigger further rate cuts to drum up the economy’s animal spirits.

Fiscal policy: For whom the bell tolls

Cyclicality of fiscal policy

Over the years, the government has adopted the use of benchmarks (oil production and prices) in preparing its budgets to protect its expenditure from the volatility in oil prices. While revenues have been largely correlated with oil prices, government spending has been mostly financed by borrowings amid persistent revenue shortfalls. During the first half of 2020, oil revenues underperformed on a year-on-year basis due to the slump in oil production and prices while non-oil revenue plunged due to slowdown-driven lower tax receipts. The contribution of oil revenue dropped from 49% in Q1’20 to 41% in Q2’20 as weak external demand and OPEC quotas limited contribution to federal revenues. Meanwhile, tax collection remained at a historical low of 6% of GDP reflecting a narrow tax base, a large informal sector and the state of the economy.

Aggregate expenditure has risen in four out of five years due to rising personnel costs and debt servicing. Capital expenditure has averaged 26% of aggregate expenditure in the past 5 years compared to a 5-year average of 31% between 2010 and 2015. While capital expenditure has declined, fiscal deficit has expanded over the years from 1.9% of GDP a decade ago to 3.9% in the first half of 2020, lending credence to the fact that recurrent expenditure (debt and non-debt) has been financed by borrowings.

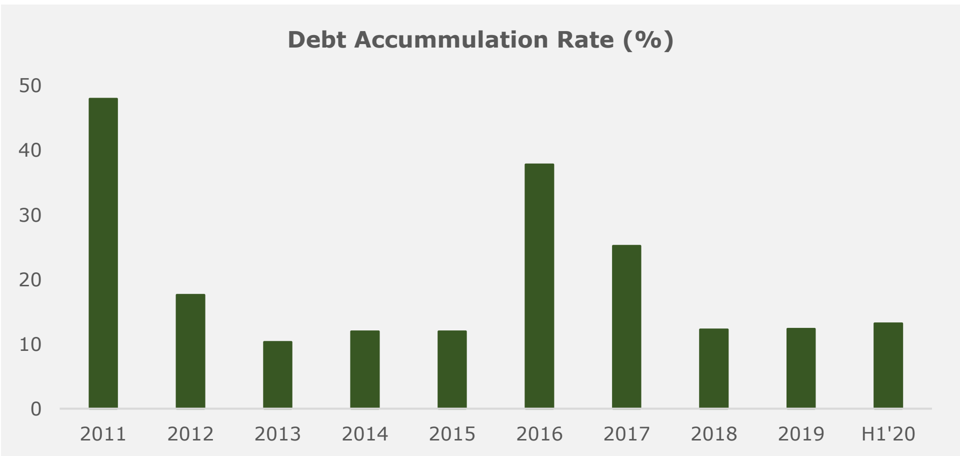


Source: CBN, Vetiva Research

The practice of fiscal federalism has seen states depend on the center for federal allocations to fund their budgets. Federal allocations made up 65% of total revenue available to the states for the first half of 2020. About 15 states depend significantly on federal allocations, as it constitutes over 80% of total revenue available to fund their budgets. Only three states generated more than half of their total revenues for H1'20 independently - Lagos (80.34%), Ogun (57.75%) and the FCT (51.58%). Thus, budget execution at the state level could be threatened by unfavourable oil prices. On the other hand, the weaker Naira would improve FAAC inflows in 2021.

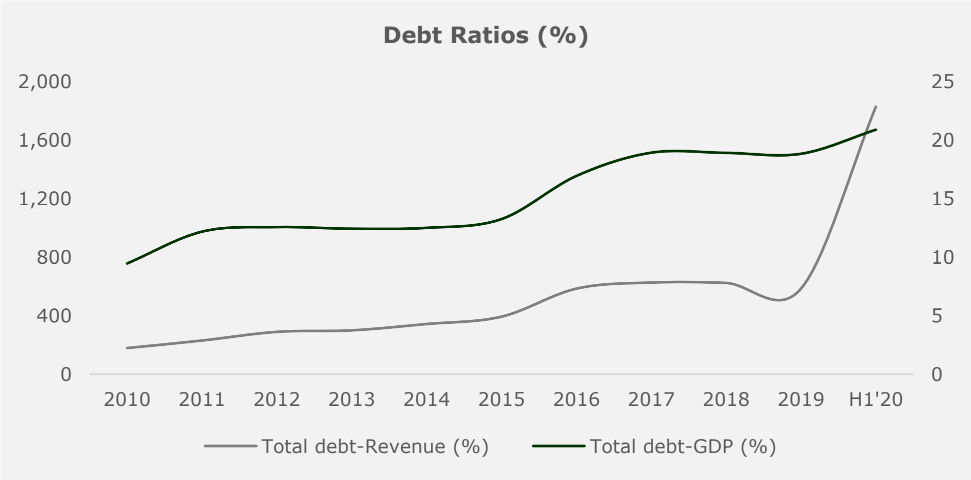
Debt sustainability: The COVID-19 rabbit hole

Given growing expenditure needs and cyclical revenue flows, Nigeria's fiscal deficit is financed mostly by undertaking debt. Since June 2018, the country's debt level has increased consistently. The government had embarked on new external borrowings including Eurobonds and Green bonds to support its expenditure operations. The need to borrow has increased given the blow dealt to oil revenues by the COVID-19 pandemic. As we witnessed in 2016, where the slump in oil prices necessitated a spike in borrowing, there might be a need for rapid accumulation of debt between 2020 and 2021, depending on the pace of recovery in oil prices.



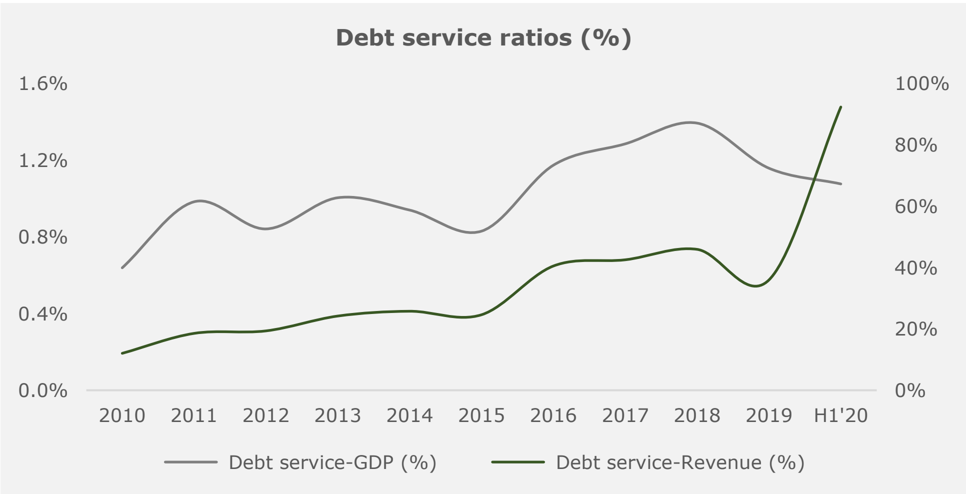
Source: DMO, Vetiva Research

As at Jun'20, public debt increased by 13% to ₦31.00 trillion (Dec'19: ₦27.40 trillion), majorly driven by the $3.4 billion IMF budget support inflow from the IMF under the Rapid Credit Facility and the devaluation of the Naira. The domestic-external debt mix has tilted in favour of external debt from 67:33 at the end of 2019 to 63:37 by the first half of 2020, as the government seeks to limit the crowding out of the private sector. The government shelved its plans to undertake a $3.3 billion loan from the Eurobond market earlier in the year due to the negative impact of COVID-19 on oil prices and the debt environment. The pandemic triggered an elevation in yields, making commercial borrowing more expensive. Thus, Debt to GDP ratio has risen to 22.2% of GDP in H1'20 (H1'19: 17.8%), barely 3.2% away from the country's threshold of 25%, yet lower than peer countries such as South Africa (62.1%) and Kenya (62.4%). While debt-to-GDP suggests that Nigeria earns enough to service its debts, the country's debt-to-revenue ratio tells a different story. The massive accumulation of debt has put pressure on the Nigeria's revenue, a situation that is compounded by the further weakening of the Naira.



Source: CBN, Vetiva Research

The servicing of both interest and principal has grown over the years due to increased accumulation of debt and weakening of the Naira. Although, debt service-to-GDP is less than 2% of GDP, yet debt servicing continues to gulp higher proportions of revenue. From 12.0% of revenues in 2010, debt servicing-to-revenue rose to a peak of 36% in 2019. Debt servicing takes more of government revenue than capital expenditure does. Thus, the government needs to ensure borrowings are channeled towards capital projects such as power and network infrastructure. This would enable the multiplier effect to be effective as more businesses are formed in the process and the tax net expands.



Source: CBN, NBS, Vetiva Research

Due to the attendant impact of low oil prices, credit rating agencies reviewed Nigeria's sovereign ratings. Between March and April, the top three agencies had issued either a credit rating downgrade or a negative outlook on the country. Standard and Poor's earlier downgraded Nigeria's long term foreign and local currency from B- to B. While Moody's maintained its negative outlook on Nigeria's sovereign rating. In the year, however, Fitch revised Nigeria's outlook from negative to stable, following the decrease in the level of uncertainty surrounding the impact of the pandemic on the economy.

Fiscal Reforms: Fair winds and following seas

The Federal Government has implemented a couple of reforms in ensuring fiscal sustainability. The move to shore non-oil revenues by increasing the Value Added Tax (VAT) from 5% to 7.5% was a step in the right direction, considering the fact that Nigeria's tax-to-GDP (which is historically low at 6%) is lower than comparable countries - South Africa (25.1%), Ghana (12.8%) and Kenya (14.5%).

The dent on oil prices brought an ample opportunity to phase out subsidies. Although the slump in oil prices saw fuel prices fall slightly, the recovery in oil prices saw a gradual rise in monthly retail price bands as an automatic fuel price formula had been put in place to guide pricing and prevent subsidies from reemerging.

In addition, the two-step devaluation of the Naira from ₦305/$ to ₦379/$ would result in higher federal revenues. The 2021 budget was premised on an oil price benchmark of $40, which is higher than the 2020 revised benchmark of $28. Oil production was pegged at 1.86 million barrels per day (including condensates) due to existence of OPEC production limits.

Budget Aggregates	Approved 2020 Budget (Jul'20)	Proposed 2021 Budget (Sep'20)	Variance (%)
Assumptions			
Oil price ($/bbl)	28.00	40.00	43%
Oil production (mbpd)	1.80	1.86	3%
Exchange Rate (₦/$)	360.00	379.00	-5%
Real GDP Growth rate (%)	(4.20)	3.00	-171%
Inflation (%)	14.15	11.95	16%
Aggregate Revenue (₦'bn)	**5,365.67**	**7,886.00**	**47.0%**
Oil revenue (₦'bn)	1,013.77	2,011.02	98.4%
Non-oil revenue (₦'bn)	1,624.93	1,488.92	-8.4%
Aggregate Expenditure (₦'bn)	**10,810.80**	**13,080.42**	**21.0%**
Recurrent (₦'bn)	7,893.98	8,994.25	13.9%
Capex (₦'bn)	2,488.79	3,603.68	44.8%
Statutory Transfers (₦'bn)	428.03	484.49	13.2%
Deficit Financing			
Fiscal Deficit (₦'bn)	(5,445.13)	(5,194.42)	-4.6%
Nominal GDP (₦'bn)	142,960.53	147,249.35	3.0%
Deficit-GDP (%)	(3.81)	(3.53)	-7.4%
Expenditure Ratios			
Recurrent -Total Expenditure (%)	73.02	68.76	-5.8%
CAPEX-Total Expenditure (%)	23.02	27.55	19.7%
Revenue Ratios			
Recurrent Expenditure-Revenue (%)	147.12	114.05	-22.5%
CAPEX-Revenue (%)	46.38	45.70	-1.5%
Deficit-Revenue (%)	(101.48)	(65.87)	-35.1%

Source: Budget Office, Vetiva Research

The executive arm presented the 2021 Budget, tagged the Budget of Economic Recovery and Resilience. The ₦13.08 trillion budget indicates a 21% increase above the revised 2020 budget. The expansionary tone of the budget saw projected deficit exceed the legal 3% limit for the third consecutive time. The deficit may eventually exceed the current threshold after review by the National

Assembly. To fund the budget, the government indicated its intentions to raise ₦4.28 trillion in new borrowings, ₦205.15bn from privatization proceeds and ₦709.69bn in bilateral and multilateral loans.

The budget seeks to plug leakages by deregulating the price of petroleum products, implementing service-based electricity tariffs and carrying out personnel verification exercise. The Federal Government also earmarked expected revenue contributions from 60 Government owned enterprises (GOEs). We note that placing limits on the cost-to-revenue ratios of GOEs is a step in the right direction, however, it is essential that revenue generation efforts do not degenerate into rising costs of doing business in the country as it can intensify existing inflationary pressure.

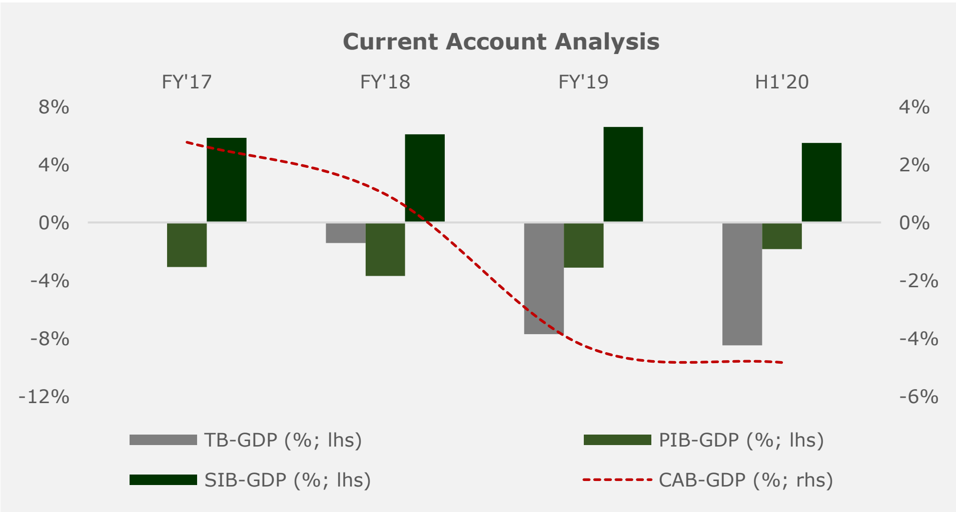
Fiscal policy in focus

The need to revitalize economic growth will be the focus of the 2021 expenditure plan, as such, we anticipate another year of fiscal expansion. While we note that budget execution at both the Federal and State levels could be threatened by low government revenues from oil and taxes, the weakening of the Naira is likely to improve the value of FAAC inflows in the coming year. Extravagant spending plans, amid depressed oil prices, could necessitate a spike in borrowing. As such, there might be a need for rapid accumulation of debt between 2020 and 2021, depending on the pace of recovery in oil prices. The accumulation of debt would increase the country's debt-servicing obligations and could crowd out capital spending. Thus, we believe it is necessary for the government to ensure borrowings are channeled constructively towards capital projects such as power and network infrastructure to enable the economy to reap the multiplier effect of such borrowings.

External sector: Uncertainty surrounds external outlook

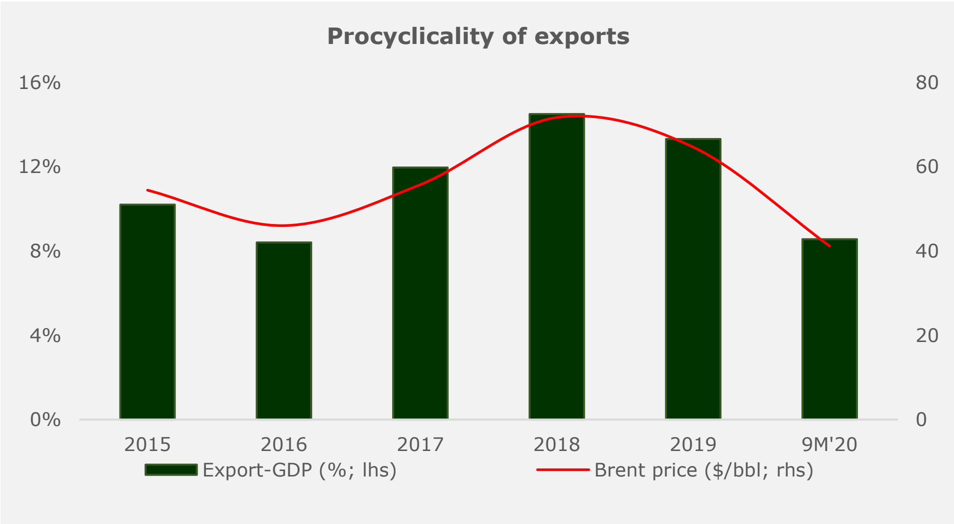
Balance of payment analysis

The external sector has reflected the impact of the pandemic from external balances to terms of trade and exchange rates. The current account balance (CAB) has been in a deficit position for eight quarters due to persistent deficit in the services segment. However, the merchandise trade balance has been in a deficit position since Q4'19, indicative of the impact of the pandemic on goods exports. Thus, the trade gap has widened, alongside the primary income balance (PIB). However, the secondary income balance (SIB) has remained in the positive region supported by remittance inflows.



Source: CBN, NBS, Vetiva Research

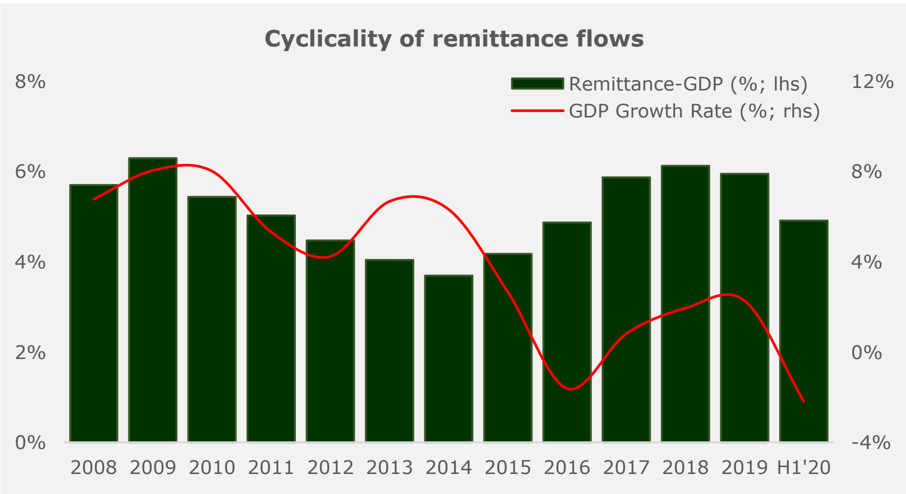
The CAB continues to trail the trade balance. Despite the pandemic, the country's import bill grew by +19.79% y/y in 9M'20 due to the increased appetite for foreign products specifically food, manufactured goods and machines. Meanwhile, exports fell significantly during the same period (9M'20: -35.55%), no thanks to the sharp decline in oil prices triggered by the breakdown in OPEC+ agreements and slowdown in external demand. Crude exports, which is responsible for 81% of total exports (Q3'19: 71%) fell by 37% y/y in the first nine months of 2020.



Source: CBN, NBS, Vetiva Research

The PIB, which captures both compensation of employees and investment income, has been in the deficit region due to low investments abroad by domestic investors and relatively high investment inflows from non-residents. As a result, dividend payments to foreign entities continue to mask the income receipts to domestic investors. On the other hand, compensation to residents of the Nigerian economy exceeds the payment to foreign residents due to outsourcing activities.

The SIB has been strong over the years due to remittances, which constitute over 80% of transfers. The strong presence of Nigerians in diaspora and the pace of emigration has resulted in consistent remittance inflows over the years. Remittances constitute about 6% of GDP as the country remains one of the top destination of remittances in Africa. In H1'20, remittances fell to its lowest in four years due to the closure of air borders that slowed emigration rate, as well as job losses and pay cuts in advanced economies.



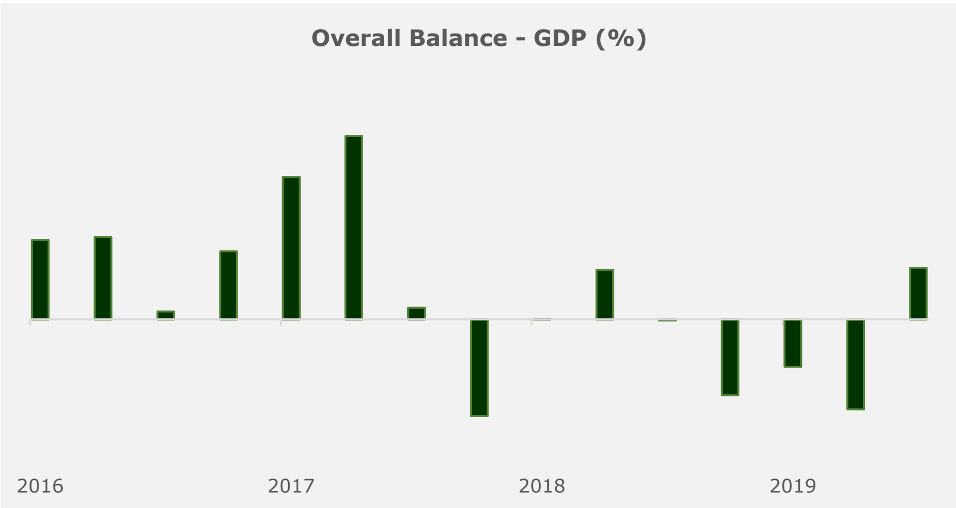
Source: World Bank, CBN, Vetiva Research

The financial account balance reflects how the current account balance is utilized. A surplus in the CAB can be lent to foreigners while a deficit can be financed by incurring of liabilities from foreigners. In 2019, the attractive yield environment supported the attraction of foreign investors to short term debt securities via Open Market Operation and Treasury bill instruments. However, capital flow reversals resumed in 2020 as foreign portfolio investors dumped Naira assets. A c.91% slump in foreign portfolio investment resumed following selloffs in both the fixed income and equities market during the second quarter of 2020. Foreign direct investment, on the other hand fell by 33.4% amid weak macroeconomic fundamentals and subsisting macroeconomic challenges. The inflow of $3.4 billion from the IMF supported the financial account balance in the second quarter of 2020 and was instrumental in funding the current account deficit.

Balance of Payment Outlook

The external sector has been affected by the COVID-19 pandemic, which has been evident in trade, factor, and financial segments. Merchandise trade deficit could expand given the pick-up in import demand and slow recovery in oil prices. Oil prices are yet to recover to pre-pandemic levels despite the relaxation of lockdown measures. Due to OPEC+ agreements, oil production is capped at 1.4mbpd. Although, the federal government intends to support this with production of condensates, yet lower oil exports combined with a faster recovery in imports could widen the trade gap.

We expect reduced investment appetite for Naira assets and reduction in the remuneration to expatriates to narrow the PIB to -2.07% of GDP in 2020 (FY'19: -3.12%). However, we expect this to deteriorate to 2.95% in 2021 due to renewed risk-on sentiment from foreign investors as the low yield environment persists in advanced economies. We expect remittance inflows to slip by 12% giving room for a deeper contraction in the CAB to -9.10% of GDP (FY'19: -7.71%) in 2020. The recovery in oil demand and prices could moderate the CAB deficit to -5.69% in 2021.



Source: World Bank, CBN, Vetiva Research

The resulting impact of lower income and savings on the balance of payment could cause the trade gap to expand in 2020. The country will have to draw down on reserve assets or resort to borrowing to finance its BoP needs. We expect the country to depend on IFIs to fund the BoP gap due to heightened uncertainties in the global environment, which could raise costs of external financing. The country is yet to receive c$3.5 billion from IFIs including the World Bank and Africa Development Bank.

Despite the dovish stance in various advanced and emerging economies that has resulted in a massive supply of investible funds, the country may not be able to obtain cheaper dollar-denominated loans due to low oil prices and risk-off sentiments towards emerging and frontier markets. The direction of oil prices would dictate the financing decision as the country may only access the Eurobond window if oil prices gain momentum in 2021. Otherwise, the country would have to cope with raising expensive debt or a drawdown on reserve assets.

If current macroeconomic conditions persist, the country will have to implement loan conditions religiously to access multilateral inflows. The disbursement of a $1.5 billion loan from the World Bank has been premised on the unification of exchange rate and elimination of subsidies. The country may be coerced by an unfavourable macroeconomic environment to implement these structural changes, despite the adverse short-term implications on inflation and citizens' welfare. Thus, the government may need to make tradeoffs to drive home its objectives.

Ordinarily, the low yield environment in the domestic economy favours cheap access to credit by the Federal Government. Nonetheless, the effects of a deteriorating terms of trade needs to be addressed, either via a sharper devaluation of the Naira or build-up in external reserves. As we saw in 2017 with the introduction of the I&E window, reforms geared at unifying foreign exchange rates could attract portfolio investment and support the BoP position.

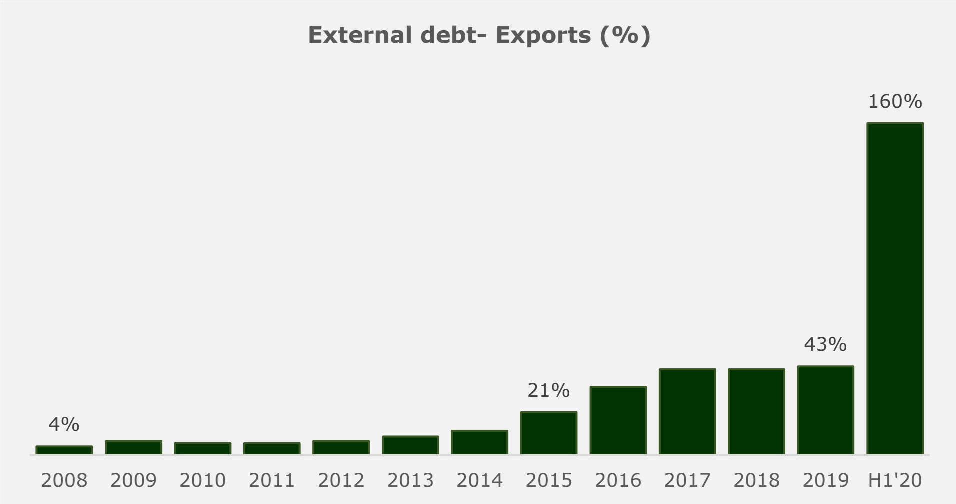
External Financing

Nigeria's external debt stock grew by 13.7% from Dec'19 to $31.5 billion in Jun'20. Over half of external borrowing is attributed to multilateral institutions, while bilateral and commercial lending constitute 12.5% and 35.5% of external debt stock, respectively. Due to the downward pressure on crude oil prices, external debt levels have risen at a faster pace within the last four years. In 2017 alone, external debt stock jumped by 66%.

Category	Outstanding Debt ($'mn)	% of Total
MULTILATERAL	**16,360.14**	**52%**
IMF	3,358.90	11%
World Bank Group	10,463.17	33%
IDA	10,053.66	32%
IBRD	409.51	1%
AFDB	2,538.07	8%
ADB	1,325.72	4%
AGTF	0.14	0%
ADF	921.91	3%
BADEA	5.88	0%
EDF	52.52	0%
IDB	30.22	0%
IFAD	201.68	1%
BILATERAL	**3,948.65**	**13%**
China (Exim Bank of China)	3,240.73	10%
France (AFD)	403.65	1%
Japan (JICA)	76.69	0%
India (Exim Bank of India)	34.87	0%
Germany (KFW)	192.71	1%
COMMERCIAL	**11,168.35**	**35%**
Eurobonds	10,868.35	35%
Diaspora Bond	300.00	1%
GRAND TOTAL	**31,477.14**	**100%**

Source: NBS, DMO, Vetiva Research

The slower pace of debt accumulation between 2017 and 2019 is set to dissipate given the recent COVID-19 induced slump in oil prices. A subdued oil price environment could see external debt rise to unsustainable levels. External debt-to-reserves ratio rose to 88% in the second half of 2020, which shows that settlement of entire debt today could lead to gross reserves inadequacy. In addition, the external debt stock-to-exports ratio has risen from 43% in 2019 to 160% in H1'20, meaning the value of Nigeria's exports cannot repay its external debt. Weak oil demand and low oil prices would see the ratio deteriorate further in H2'20, while better macro fundamentals could provide respite in 2021.



Source: CBN, Vetiva Research

External relaxers to constrain international investment position (IIP)

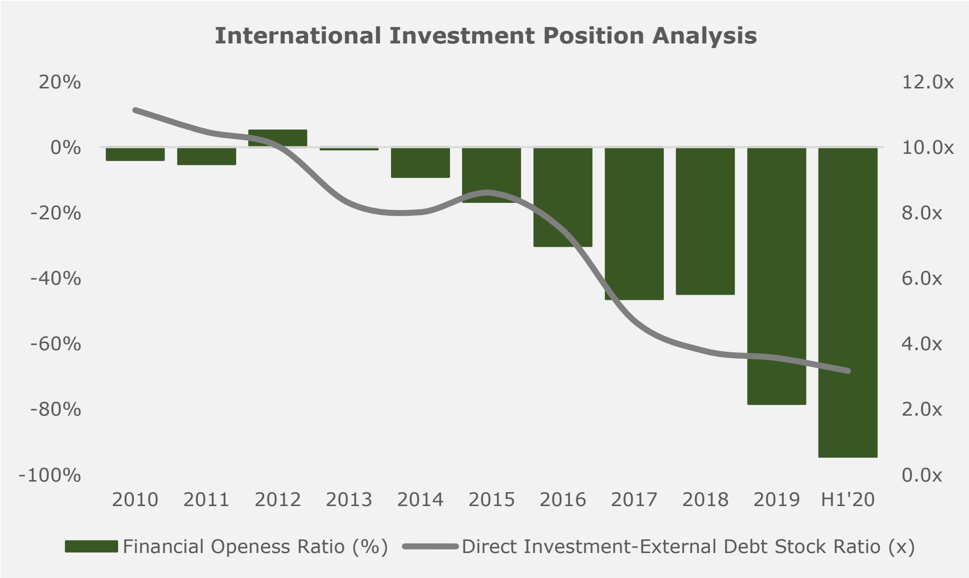
The international investment position (IIP) reflects the difference between an economy's claim on the rest on the world and the claim of the rest of the world on the economy. A positive net international investment position connotes a country is a net creditor to the rest of the world while a negative international investment position shows the country is a net debtor to the rest of the world.

Since Q3'18, the country has been in a net IIP deficit position, indicating the country has been a net borrower from the rest of the world. The incurrence of foreign liabilities by the government and increased direct investment by foreigners kept liabilities on the rise while the drawdown on reserve assets and decline of currency deposits in foreign countries led to a decline in assets. This can be attributed to attractive yields on fixed income instruments, which attracted the attention of both domestic and foreign investors in the past decade. As such, there were limited incentives for domestic investors to invest in other countries.

Although the net IIP reached its worst level on record in Q4'19 (-$85.4 billion), there was a slight improvement in Q1'20 to -$78.7 billion due to the exit of portfolio investors, which reduced foreign claims on the economy. However, the budget support inflow from the IMF and dollar injections by multinationals increased the net IIP deficit to $84.6 billion in Q2'20.

Going forward, we believe the low yield environment and risk-off sentiments towards Naira assets could reduce foreign investment in the economy in 2020 and ease IIP pressure. However, in 2021, we believe an extended low yield environment in advanced economies and anticipated recovery in oil prices could renew foreign investors' interest in Naira assets, fueling a deterioration in the IIP. In addition, we envisage a build-up in external debt by the government to address the twin deficit, which could entrench the net IIP further into the deficit region.

The sour sentiment towards Nigerian capital investments, amid a ramp up in external debt, could intensify the unfavourable IIP imbalances in the coming year. By the end of H1’20, the ratio of direct investment to external debt deteriorated further to 3.17x from 3.56x by the end of 2019, suggestive of tighter FX liquidity conditions. The FX liquidity constraint could persist in 2021 as the government ramps up long-term external borrowing, in the absence of reforms that can attract long-term external flows. While a duration mismatch between external borrowings and foreign investment might be inevitable, the risk of a foreign exchange crisis is unlikely in the near term.



Source: CBN, Vetiva Research

Foreign exchange (FX) outlook

The slump in oil prices had dire implications for the foreign exchange market in 2020. Lower oil prices ignited portfolio outflows and ushered in pent-up demand for the dollars. The resulting slide in external reserves had to be cushioned by the apex bank via an 18% devaluation of the Naira from ₦305/$ to ₦360/$.

Amid limited FX supply, banks imposed international spending limits to complement CBN’s FX management activities. Another policy that was implemented to boost foreign exchange supply was disallowing oil companies from selling FX to the NNPC. Nonetheless, a backlog of FX demand emerged from portfolio investors seeking to exit the country. In managing the FX environment, the CBN clamped down on defaulting exporters yet to repatriate their FX proceeds, and abolished third-party Form M applications. These initiatives were pertinent to check currency malpractices and prevent rapid depletion of external reserves.

Having shelved commercial borrowing plans, the receipt of $3.4 billion from the IMF supported reserve accretion. The bank had to implement another slight devaluation to ₦379/$ in Jul’20 to further converge the official exchange rates and secure a yet-to-be received $1.5 billion expected inflow from the World Bank. This informed the directive mandating BDCs to sell at ₦380/$. Nonetheless, the dollar continues to trade at a premium of over 20% in the parallel market, where most users source FX from. The exclusion of milk and maize compounded demand pressures in the parallel market and resulted in wider gaps between the official and parallel rates. In a bid to narrow the divergence in rates, the CBN directed banks to credit beneficiaries of remittances in foreign currency. Despite the resulting short-term appreciation in the Naira, demand pressures from subsisting FX restrictions could remain a headwind to FX unification efforts.

We note that advancement in vaccine development could provide recourse for oil prices. Barring the possibility of stringent lockdowns and with global adoption of safe vaccines, oil prices could recover. A pick-up in oil exports could improve dollar inflows and stabilize the Naira, despite a steady recovery in import demand.

With limited scope for cross-border flows and official development assistance, a slower pace in the recovery of oil prices will influence exchange rate decisions. We could see an adjustment to the official rate for the purpose of unifying the exchange rates, especially if macroeconomic fundamentals weaken further. We also recognize the impacts of a resurgence in COVID-19 on oil prices, given weak external demand.

In addition, OPEC's decision on the extension of production cuts into 2021 would provide clarity on the direction of oil prices. The reluctance by member countries to deliver further production cuts could send oil prices on another downward spiral, creating the need for a further devaluation of the Naira as experienced in the first half of 2020.

Period	Indicator	Forecast		
		Worst	Base	Best
Dec-20	Reserves ($'mn)	33,757.51	34,483.03	38,736.21
	I&E (₦/$)	406.55	387.00	385.50
	Official (₦/$)	379	379	369
	Parallel (₦/$)	523	480	466
Mar-21	Reserves ($'mn)	33,338.20	34,102.94	38,926.78
	I&E (₦/$)	406.87	396.29	382.92
	Official (₦/$)	400	379	369
	Parallel (₦/$)	529	490	464
Jun-21	Reserves ($'mn)	33,038.30	33,920.68	39,240.43
	I&E (₦/$)	447.10	426.42	382.71
	Official (₦/$)	400	379	369
	Parallel (₦/$)	533	500	461
Sep-21	Reserves ($'mn)	32,789.62	33,808.87	39,593.20
	I&E (₦/$)	457.29	426.51	382.49
	Official (₦/$)	400	400	369
	Parallel (₦/$)	536	510	458
Dec-21	Reserves ($'mn)	32,568.79	33,625.69	39,896.50
	I&E (₦/$)	457.46	426.65	382.30
	Official (₦/$)	400	400	369
	Parallel (₦/$)	539	515	455

Source: Vetiva Research

Foreign exchange (FX) outlook assumptions

	Worst	Base	Best
Dec-20	Brent (avg.): $37/bbl	Brent (avg.): $42/bbl	Brent (avg.): $48/bbl
	Imports restriction: Yes	Imports restriction: Yes	Imports restriction: Yes
	Wave 2 COVID-19: Yes	Wave 2 COVID-19: No	Wave 2 COVID-19: No
	Risk-off sentiment	Risk-on sentiment	Risk-on sentiment
	Crude oil sales: low	Crude oil sales: moderate recovery	Crude oil sales: strong recovery
	Spending limits relaxed: Yes	Spending limits relaxed: No	Spending limits relaxed: No
			WB flow: $1.5bn
Mar-21	Brent (avg.): $39/bbl	Brent (avg.): $45/bbl	Brent (avg.): $49/bbl
	Imports restriction: Yes	Imports restriction: Yes	Imports restriction: Yes
	Wave 2 COVID-19: Yes	Wave 2 COVID-19: No	Wave 2 COVID-19: No
	Risk-off sentiment	Risk-on sentiment	Risk-on sentiment
	Crude oil sales: low	Crude oil sales: moderate recovery	Crude oil sales: strong recovery
	Spending limits relaxed: Yes	Spending limits relaxed: No	Spending limits relaxed: No
			WB flow: $1.5bn
			AfDB flow: $0.5bn
Jun-21	Brent (avg.): $41/bbl	Brent (avg.): $48/bbl	Brent (avg.): $53/bbl
	Imports restriction: Yes	Imports restriction: Yes	Imports restriction: Yes
	Wave 2 COVID-19: Yes	Wave 2 COVID-19: No	Wave 2 COVID-19: No
	Risk-off sentiment	Risk-on sentiment	Risk-on sentiment
	Crude oil sales: low	Crude oil sales: moderate recovery	Crude oil sales: strong recovery
	Spending limits relaxed: Yes	Spending limits relaxed: No	Spending limits relaxed: No
		WB flow: $1.5bn	WB flow: $1.5bn
			AfDB flow: $0.5bn
Sep-21	Brent (avg.): $42/bbl	Brent (avg.): $52/bbl	Brent (avg.): $56/bbl
	Imports restriction: Yes	Imports restriction: Yes	Imports restriction: Yes
	Wave 2 COVID-19: Yes	Wave 2 COVID-19: No	Wave 2 COVID-19: No
	Risk-off sentiment	Risk-on sentiment	Risk-on sentiment
	Crude oil sales: low	Crude oil sales: moderate recovery	Crude oil sales: strong recovery
	Spending limits relaxed: Yes	Spending limits relaxed: No	Spending limits relaxed: No
		WB flow: $1.5bn	WB flow: $1.5bn
		AfDB flow: $0.5bn	AfDB flow: $0.5bn
Dec-21	Brent (avg.): $44/bbl	Brent (avg.): $55/bbl	Brent (avg.): $60/bbl
	Imports restriction: Yes	Imports restriction: Yes	Imports restriction: Yes
	Wave 2 COVID-19: Yes	Wave 2 COVID-19: No	Wave 2 COVID-19: No
	Risk-off sentiment	Risk-on sentiment	Risk-on sentiment
	Crude oil sales: low	Crude oil sales: moderate recovery	Crude oil sales: strong recovery
	Spending limits relaxed: Yes	Spending limits relaxed: No	Spending limits relaxed: No
		WB flow: $1.5bn	WB flow: $1.5bn
		AfDB flow: $0.5bn	AfDB flow: $0.5bn

Source: Vetiva Research

Risks to outlook: World of worries

Following a bumpy 2020, pre-existing risks could fizzle into the new year as the world continues to manage the COVID-19 pandemic. From geopolitical issues in the Middle East to the trade tussle between the US and China, escalation of these risks could weigh on global economic recovery.

Health risks

Despite hopes stirred by the vaccines, clarity on the long-term effects may take a while to unravel. In addition, there is an increasing risk that low-income countries may not have enough funding to roll out mass vaccination schemes. Just as limited testing cases occurred in EMDEs during the first wave of the virus, weaker currencies and a stalled recovery in commodity prices might constrain the capacity of these countries to respond adequately to a second wave of outbreak. The biting health crisis had caused some developing countries to enroll in vaccine trials, betting on the possibility that a successful vaccine could ameliorate the economic consequences. While other vaccines are in the final stages of clinical trials, we cannot overrule the possibility of a rise in local transmission and second spate of lockdowns.

Politics & geo-politics

As vaccine development become successful, we may witness a return of buried geopolitical tensions. Starting out with tensions in the Korean peninsula, the emergence of a Biden Presidency could see the re-emergence of nuclear weapon tests, which could stir provocations and unrest in the Middle East. Moving to Iran, the decision of the US President as regards the abandoned Joint Comprehensive Plan of Action (JCPOA) could awaken US-Iran tensions.

In addition, the election of a stricter Iranian president may result in heightened risks, as the incumbent leader is constitutionally restricted from contesting for a third term in office. Tensions at the Strait of Hormuz could resume from vengeful attacks against oil tankers, following the murder of the Iranian leader. The power play between these key forces could arouse tensions in the world and dampen growth prospects.

There are renewed concerns about a no-deal Brexit following attempts by the UK to overrule parts of the agreed withdrawal agreement with the European Union. This could degenerate into a no-deal Brexit if talks breakdown between the duo. While the UK is firm on not extending the transition period, the passage of the bill could breach international law and strain relations with the EU. With these uncertainties, investment spending could be constrained further compounding challenges of UK businesses.

Economic risks

With the pandemic came the need for de-globalization, as the disruption in supply chains weighed on production levels in several economies. Thus, economies experienced for the first time, the implications of relying on long supply chains involving several countries. In addition, some countries imposed export restrictions on key commodity exports during the first wave of the virus, lending credence to a rise in protectionism.

With regards to souring US – China tensions, the tussle could re-emerge cutting across economic, technological, and military spheres. This could result in a downturn in the Chinese manufacturing industry and by extension, resource-dependent emerging economies. Lower commodity prices could worsen the fiscal and external balances of these economies, who will have to cope with weaker revenues, overvalued currencies, and the depletion of reserves assets.

Financial risks

• <u>High sovereign debt levels could create a vicious cycle in an economic slowdown</u>

Given the worrisome debt levels of some EMDEs, countries in distress could find it difficult to service debt obligations amid uncertainty on the recovery of trade and capital flows. Where currencies have not taken a hit, reserves have felt the impact of pandemic-induced selloffs, as investors took a flight-to-safety in safe-haven assets. With a likely extension of debt reliefs to the first half of 2021, EMDEs may witness difficulties in securing vaccines independently and providing safety nets for vulnerable social groups.

The emerging world could be on a brink of a debt crisis once debt relief programs elapse. Fears of possible credit rating downgrades could cause some economies to keep repaying debts at the expense of the economy. With the absence of sizeable policy interventions, economies might not recover as earlier anticipated. Instead, we could see widespread poverty, increased inequality, unemployment, and socio-economic regression inciting protests and social unrest in emerging economies. Thus, worrying debt levels could stall public investments needed to gear economies on the path of recovery.

• <u>Corporate debt in US & China</u>

Before the pandemic hit the global economy, the IMF had warned that 40% of corporate debt in major economies could be at risk upon the occurrence of a global downturn. In the US, corporate debt has risen sharply to over 70% of GDP. The downgrades issued by leading rating agencies in Mar'20 was the highest in nearly two decades as the pandemic uncovered risks in several sectors and inducing a spike in non-performing loans and credit losses. The price of insurance against debt defaults as captured by credit default swaps rallied to levels seen during the global financial crises, indicating heightened risks of corporate debt defaults. Thus, the event of swinging from a health and economic crises to a financial crisis could downplay global recovery, due to the possible contagion effects of a corporate debt crises in these major economies.

•<u>Loose global monetary policy could further exacerbate financial risks</u>

As a result of the ultra-loose monetary environment, we could see further piling up of debt. The rise in credit, which provides room for business expansion has not been matched by recovery in demand, and as a result firms could absorb more than necessary. More so, repayment risks could arise from other economic shocks that may arise during the new year. A lot of central banks relaxed macroprudential guidelines and granted forbearance for restoring economies to the path of growth. While this has a short-term benefit of freeing up access to capital, possibility of credit losses could escalate credit risk and strain the banking system.

Environmental/Climate risks

The occurrence of natural disasters could pose a major risk in a receding global economy. Although environmental risks have subsided due to lower carbon emissions, a rise in global temperature levels could result from the pick-up in industrial production. Increased global warming could snowball into flooding due to rising sea levels, having significant effects on plants and humans. On the other hand, natural disasters could result in losses of buildings and infrastructure, which could dampen recovery efforts and require deeper interventions by the affected governments.

Security risks

From the Black Lives Matter protests in the US to citizenship law concerns in India and anti-police brutality protests in Nigeria, a wave of protests spanned through 2020, as the socio-economic consequence of inequality and poverty aroused dissatisfaction and unrest in countries across the globe. A possible recurrence of these protests in 2021 could result in dire implications for these economies as increased political risks dampen investors' confidence and delay investment decisions. The economic consequences of the pandemic could fuel civil unrests in 2021, as the rise in unemployment spur protests and revolts in emerging economies.

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